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Covanta Holding Corp. (CVA)

Q1 2018 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, everyone, and welcome to the Covanta Holding Corporation's First Quarter 2018 Financial Results Conference Call and Webcast. An archived webcast will be available two hours after the end of the conference call and can be accessed through the Investor Relations section of the Covanta website at www.covanta.com. The transcript will also be archived on the company's website.

At this time, for opening remarks and 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 first quarter 2018 conference call. Joining me on the call today will be Steve Jones, our President and CEO; and Brad Helgeson, our CFO. We will provide an operational and business update, review our financial results, and then take your questions.

During their prepared comments, 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 the website, www.covanta.com. These prepared remarks should be listened to in conjunction with these slides.

Now on to the Safe Harbor and other preliminary notes. The following discussion may contain forward-looking statements and our actual results may differ materially from those expectations. Information regarding factors that could cause such differences can be found in the company's reports and registration statements filed with the SEC. The content of this conference call contains time-sensitive information that is only accurate as of the date of

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this live broadcast, which is April 27, 2018. We do not assume any obligation to update our forward-looking information unless required by law. Any redistribution, retransmission or rebroadcast of this call in any form without the express written consent of Covanta is prohibited.

The information presented includes non-GAAP financial measures. Because these measures are not calculated in accordance with U.S. GAAP, they should not be considered in isolation from our financial statements which have been presented 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. Good morning, everyone. For those of you using the Web deck, please turn to slide 3. I'll provide a brief overview of the financial results along with an update on some of our strategic initiatives, and I'll go through more color on the key drivers that impacted the quarter. We started the year off strong with $100 million of adjusted EBITDA. Our free cash flow before working capital was improved versus last year and along with our working capital usage was in line with our expectations. These results position us well to meet our full year guidance on all of our metrics, which we are affirming today.

During the first quarter, our fleet showed improved performance compared to the first quarter of 2017. As many of you will recall, during Q1 2017 we had significant unplanned downtime at three plants, one of which was Fairfax, which weighed on our performance throughout the quarter and increased operating costs. This year, we experienced more normal performance without the material unplanned downtime that was incurred in 2017.

The Fairfax County facility in Virginia restarted in late December after nearly a full year of downtime due to a fire. Investments we made prior to that event are paying off and the plant is now running at record levels. In the first quarter the plant processed more waste than it had in any prior first quarter while achieving the highest quarterly power generation in its history.

I'm very proud of our recovery as we work closely with the client, the local community and insurers with significant efforts by all parties to get to this point. The plant is now meeting the expectations we set out a couple of years ago, and this performance is a key component of the improvement both this quarter and in our full year guidance.

In other positive news, The New York City Department of Sanitation issued a Notice to Proceed for the 91st Street Marine Transfer Station, or MTS, in Manhattan. This is the second of two MTSs where we have a 20-year waste disposal contract. We already receive 475,000 tons annually from the North Shore MTS in Queens. And we expect that when fully ramped, we'll take about 175,000 tons from 91st Street.

Over the next year, we will procure and install the infrastructure to support the startup of the facility, which is scheduled for March 2019. We have provided New York City with sustainable waste solutions for many years and look forward to this expanded opportunity to provide these critical services.

Lastly, as we discussed on our fourth quarter call, we closed on the Dublin transaction with the Green Investment Group, or GIG for short. On February 12, 2018, the $167 million in cash received was used to reduce leverage, which Brad will review during his presentation. From a business standpoint, we continue to operate the Dublin plant and it is performing at a very high level.

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Our development efforts with GIG in UK are progressing. The Rookery plant has received its operating permit, and we understand through social media that a local group may file a claim challenging the permit. The UK Environment Agency will aggressively defend its decision to grant the permit. And given the Environment Agency's rigorous permitting process, we expect that the claim will fail.

Along with our partners, we will continue project development without interruption and we'll assess what effect, if any, this claim may have on our project financing schedule. At the same time, we continue to work with our partners through key development steps on the Protos, Newhurst and GIG projects including waste agreements, EPC negotiations and permitting. Several of these projects are targeted to move into full construction by the end of next year.

Now, I'll get into the detail on our markets and operations. I'll start with the waste business. Please turn to slide 4. Waste and service revenue was a strong contributor to the first quarter as we realized 6% same-store volume growth, primarily due to a full quarter of operations at Fairfax. Outside of Fairfax, the balance of our fleet also performed better year-on-year with less downtime, and we expect strong year-over-year volumes throughout 2018.

Same-store pricing improved by 2% due to contractual escalators, contract repricing and improved spot prices. Dublin added $13 million of revenue in the quarter as it processed nearly 160,000 tons of waste and continues to perform very well. As all of you know, profiled waste is a key growth opportunity and we believe our plants offer a unique and preferred solution for many forms of commercial and industrial waste.

Our Covanta Environmental Solutions business drove 1% growth in profiled waste revenue at our Energy-from-Waste facilities while achieving 10% revenue growth in our material treatment, disposal and recycling service lines. We expect to see continued expansion of this business over the course of the year as we increase utilization of existing sites and complete projects designed to help process more volume in the Covanta network.

So let me highlight two examples of this progress. First, we completed construction of a material processing facility, or MPF, for profiled waste near our existing Indianapolis Energy-from-Waste plant. This is a key addition to our portfolio as it expands our capability to manage and treat different types of industrial and commercial waste while improving logistics and ultimately increasing the total volumes of both solid and liquid profiled waste that we can accept.

Second, we made strides to enable further growth of our healthcare solutions capabilities, a business focused on offering superior, secure destruction services for expired and unused pharmaceuticals and providing disposal for regulated medical waste that can't be landfilled as it requires thermal treatment. In order to enhance these capabilities, we received a permit to process regulated medical waste at a third plant in our EfW fleet. The pricing for this type of waste is significantly higher than MSW and we're focused on replacing MSW with this higher-priced waste. Over time, we hope to add this disposal capability at incremental EfW facilities as well. We're separately focused on expanding our efforts to take on more expired and unused pharmaceutical waste in order to provide a broader solution for this growing market. We're expanding our DEA-licensed sites which allows us to increase the revenues from this line of business. Our goal is to be the preferred provider of disposal services to companies that collect these materials. We remain confident our full year profiled waste revenue will approach double-digit growth year-over-year, and this will be a key driver of our overall same-store pricing growing by at least 3%.

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Now let's move on to energy. Please turn to slide 5. First quarter energy revenue increase a solid 16%, including nearly 10% same-store improvement. Similar to waste, the biggest driver was improved volumes given the full quarter impact of Fairfax. Same-store pricing also increased 3% in Q1 as we benefited from colder weather which had a positive impact on market pricing. The improved power prices in the first quarter were welcome but were not accompanied by better forward prices, so the full year expectation for power prices and revenue is unchanged. The operations at Dublin kicked in another $5 million in revenue during the quarter. However, going forward, we will not receive power revenues from Dublin under the O&M agreement that we will still participate in the plant's performance through our 50% ownership. Lastly, we continue to prudently reduce risk in line with our historical policies. For 2018 we retain nearly 1.5 million megawatt hours of open exposure, which represents less than 25% of total expected generation. At the same time, we're actively reducing our market position in 2019 and 2020.

Let's move on the metals business on slide 6. In what has been a common theme this quarter, we also saw year-over-year gains in metals with improvements in both price and volume. On the ferrous side, first quarter same-store realized prices increased by 12% driven primarily by an 18% increase in the HMS index year-over-year. With improved plant performance, in particular at Fairfax, we also saw recovered volumes grow by 7% while quarterly sales volumes increased year-over-year as we did not build inventory the way we did in 2017. For the full year, we still expect year-over-year growth in tons recovered and in tons sold. Ferrous pricing remains firm with the HMS 1 index averaging $321 per ton in the first quarter. Pricing has further improved in April with HMS setting at $353 per ton. Domestic mill utilization is high amid solid demand and we believe the initial impacts of the Section 232 tariffs are positive. In light of the strong pricing year-to-date, though with some caution on the long-term outlook, we have modestly increased our full year range for HMS to $250 to $300 per ton.

We have a similar positive story on the non-ferrous side with same-store pricing nearly doubling year-over-year given the impact of our non-ferrous processing facility in Pennsylvania which started in the second quarter of 2017. Non-ferrous recovery improved by over 20% due to both greater plant throughput and an increase in non-ferrous recovery equipment. Sales volumes fell by 40% given the reduced saleable volumes left after processing. As we've discussed in the past, the pricing benefit of processing far outweighs the volume reduction.

To close out this discussion on metals, I wanted to touch on the current and potential impacts of tariffs and trade on our business. As most of you know, the U.S. imposed Section 232 tariffs of 25% and 10% respectively on imports of steel and aluminum. The immediate result of these tariffs was to drive increased domestic production of these products and, by association, increased demand for inputs like scrap ferrous and non-ferrous. The results of these actions are visible in the improved prices for steel, aluminum, and copper. While the initial impact of these developments has been positive, we have seen and could see more retaliatory activity out of China and other countries which could reduce demand for some of our metals products. We will carefully monitor the markets as the year progresses.

Let's now move on to maintenance and operating expense. Please turn to slide 7. Total Energy-from-Waste maintenance spend for the quarter, including both expense and CapEx, was $133 million versus $122 million last year. We have now completed 33% of our expected full year Energy-from-Waste maintenance spend. And given our experience to-date, we remain comfortable with our full year range of $390 million to $410 million. I would note that while our total number for the quarter is higher than last year, the mix is materially different. On the expense side, we're lower this year due to timing as we have a bit more maintenance expense planned for Q2 than we did in 2017 and also due to reduced unplanned outages which tend to carry higher costs. On the CapEx side, we did have an increase in Q1 but that was in line with our full year expectations.

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Outside of maintenance, other plant operating expenses increased 9% year-over-year; the biggest driver of this increase at our Energy-from-Waste operations was Dublin. Non-Energy-from-Waste operating expenses were driven by growth in the Covanta Environmental Solutions platform and the impact of the non-ferrous processing facility. As we look out to the balance of the year, I expect Energy-from-Waste costs to migrate higher primarily due to the inclusion of Dublin, while non-Energy-from-Waste operating costs should see less growth as we pass the start-up of the anniversary of the non-ferrous processing plant in Pennsylvania. Lastly, as an update on insurance, we received $7 million in business interruption proceeds during the quarter and we expect another $5 million in the second half of the year.

One last note. I'm very pleased with our results in Q1. We had a very successful quarter. It sets us up nicely for the full year. I want to thank our employees for the hard work and focus related to sourcing waste, undertaking outages, and operating our facilities, all done in a safe and reliable manner. We're committed to continuing this performance as we move through this fiscal year.

With that, I'll turn the call over to Brad to discuss the quarterly 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 first quarter financial performance with revenue on slide 9. Total revenue was $458 million in the quarter, up $54 million over last year. Excluding commodity prices, we grew the top line by $28 million organically. As Steve discussed, we have strong performance across our fleet, particularly at Fairfax. Commodity prices provided a modest benefit with a more normal winter helping drive $3 million of energy price improvement as compared to last year, and higher scrap steel and non-ferrous prices adding another $2 million. Dublin operations added $17 million of revenue in the quarter which consisted of consolidated results of the project company prior to closing our JV with the Green Investment Group in February then service revenue earned under our O&M contract with the project after closing. This makes up the vast majority of the transactions category. For modeling purposes, you should expect the year-over-year revenue contributions from Dublin to be smaller in future quarters, in particular the fourth quarter as we anniversary a quarter of operations under 100% ownership last year. Lastly, long-term contract transitions were a net $2 million tailwind in the quarter resulting from better waste prices under new contracts and reduced client energy revenue sharing.

Moving on to slide 10. Adjusted EBITDA was $100 million in the first quarter, an increase of $49 million over Q1 in 2017. Adjusted EBITDA grew by $28 million on an organic same-store basis, with a full quarter of strong operations at Fairfax being the most significant driver contributing an additional $24 million year-over-year inclusive of $6 million of business interruption insurance proceeds received in the quarter.

Beyond Fairfax, we saw improved overall results across our fleet as we experienced significantly less unplanned downtime compared to last year. On the commodity front, in line with revenue growth, we saw $4 million of adjusted EBITDA benefit from improved energy and metals prices. Dublin operations contributed $13 million of adjusted EBITDA this quarter, again reflecting a portion of the quarter with 100% ownership and the remainder at our 50% ownership through the JV.

It's fair to expect that this year-over-year benefit will be lower in the second and third quarters given our 50% ownership going forward. And in the fourth quarter, we'll lap our 100% ownership from Q4 2017. Regardless, outside of Fairfax, Dublin is by far the largest driver of year-over-year adjusted EBITDA growth.

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Contract transitions represented a net positive $4 million in the first quarter. Bear in mind that we still expect transitions to be a net headwind for the full year, particularly in the third quarter, as we recorded a benefit from the Hennepin County settlement last September in connection with our exit from that contract.

Looking ahead to the second quarter, I'd note two more things as you refine your models. First, our second quarter maintenance activity should be fairly similar to Q1. This represents a slightly different sequential mix as compared to 2017 and reflects a maintenance plan that is more heavily first half-weighted this year.

Second, if you recall, we received significant Fairfax insurance recoveries in the second quarter last year, while this year we expect to receive the remainder of our insurance recoveries in the second half.

Turning to slide 11, free cash flow was negative $52 million in the quarter, which reflected much of the working capital outflow that we anticipated this year. You should expect to see working capital movements normalize dramatically from here. Before working capital, free cash flow improved $14 million year-over-year in what is seasonally our weakest cash flow quarter.

With adjusted EBITDA of $49 million higher, it's worth discussing some of the other factors that impacted cash flow during the quarter. First, based on our maintenance plan for this year, we anticipate a higher mix of maintenance CapEx versus maintenance P&L expense as compared to last year. This proved out in the first quarter as maintenance CapEx, including capital type expenditures at client facilities, increased by $17 million. Again, this increase was in line with our expectations and our full year guidance.

Second, with the Dublin plant moving to 50% ownership, we included our proportional share of adjusted EBITDA, but will only record cash flow to the extent of project dividend distributions which, this year, are not expected until the fourth quarter.

Lastly, we had a couple of unique items in the quarter. During the first six weeks of the year, all free cash flow at Dublin was contributed into restricted accounts under the project financing structure as was the case in the fourth quarter of 2017, which represented an $11 million headwind to reported consolidated free cash flow. Also, we incurred a combined $4 million of cash costs relating to the GIG transactions and severance, which are excluded from our definition of adjusted EBITDA.

But looking past these ins and outs for the quarter, the real summary is that our strong operating performance has us squarely on track for full year guidance ranges for cash flow. And as a company, we remain most focused on our target to hit $250 million of sustainable annual free cash flow by the middle of the next decade.

Moving on to our growth investments. Please turn to slide 12. For 2018, we plan to invest around $20 million in organic growth projects relating primarily to material processing facilities, or MPFs, in our CES business and increased metal recovery. That outlook is unchanged.

Further, as Steve noted, we're now officially moving ahead with our preparations for the New York City 91st Street Marine Transfer Station. We expect to spend a total of around $35 million on transportation equipment, with roughly $15 million this year and the balance in 2019. Most, if not all, of this equipment will be efficiently lease financed.

In Dublin, we expect to spend a further $25 million for deferred final retainage type payments to contractors following construction completion last year. This amount was fully accrued and cash- funded as of year-end, so has no impact on our corporate cash and was included in our previously discussed total plant capital budget. So

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there's no change there; it's just timing of final payments. Lastly, to be clear, these expectations for growth investment excludes spending on our total ash processing project and Rookery, as we await clarity on the timing of those investments.

Please turn to slide 13 where I'll conclude with an update on our balance sheet. At March 31, 2018, net debt was $2.4 billion, down $69 million from year end 2017. This improvement relates primarily to the cash received from the GIG transaction, which we repatriated and used to repay revolver borrowings. The combination of this cash along with our improved adjusted EBITDA resulted in our consolidated leverage ratio improving by nearly a full turn from last quarter to 5.6 times. While we're certainly not yet where we want to be, we've made material strides since the third quarter of 2017 when our consolidated leverage peaked at 7.2 times.

Clearly, we're on the path of de-leveraging that I have described for the past several quarters. On the senior credit facility covenant ratio, we ended the quarter at 3 times which provides us more than ample liquidity and flexibility. As a reminder, this covenant calculation excludes our $1.2 billion of holding company notes.

Looking at the rest of the year, all else being equal, we anticipate remaining in this range on both leverage ratios. Pending the timing of investments and quarterly cash flows, we may even see leverage tick higher next quarter. However, our long-term plan remains to de-lever meaningfully further with our next target to reduce leverage below 5 times. And we'll remain highly disciplined in our capital allocation in order to continue to move towards this goal.

With that, operator, we'd like to move to Q&A.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Our first question comes from Tyler Brown of Raymond James. Your line is open.

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

Morning, Tyler.

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

Q

Hey. So nice to see the EBITDA bridge not having any red bars in it this quarter, but it does sound like there's a few things that we should think about for the remainder of the year. So can you help me with the bridge a little bit?

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So basically what is the full-year drag from Hennepin including the settlement, the New England PPA transitions and maybe the Babylon debt service this year?

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

A

Yeah, sure. Hey, Tyler, it's Brad. So what I'll do is I'll refer you to the 2017 over 2018 bridge that we put out on the fourth quarter call to support our 2018 guidance. So on a full year basis, and obviously you can extrapolate to the rest of the year and I'll get to some of the quarterly cadence in a second, on a full year basis for the contract transitions we expect a net headwind of $15 million on the waste and service side; most of that is Hennepin. $10 million out of the $15 million is the fact that we had a positive settlement related to the Hennepin contract in the third quarter last year, and this year obviously that won't recur.

And then there's another $5 million of net headwinds for the year on energy, and that's the hangover from the PPA expirations in New England. We didn't really see that in the first quarter because seasonal market prices are higher in the first quarter, and so compared to the contract you didn't have much of a drag. But over the course of the year, we think it's about $5 million.

So as we think about how does that going to play out for the rest of the year, as I mentioned in the prepared remarks we had a meaningful recovery on business interruption insurance in the second quarter, in particular last year, so that'll be a year-over-year headwind in the second quarter. The Hennepin settlement was in the third quarter. Then of course in the fourth quarter, from an EBITDA standpoint, we posted $20 million of EBITDA from the Dublin project. Under the joint venture, the contribution this year won't be as significant.

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

Q

Okay. And can you remind me on the Fairfax insurance proceeds? So it sounds like it'll be about $12 million collectively for this year. What was it last in total or do you have the cadence? I apologize.

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

A

Yeah. So business interruption just in terms of what impacts adjusted EBITDA, business interruption recoveries this year we expect to be $10 million, $6 million of which we already collected in the first quarter and then we expect about another $4 million in the second half. Last year on business interruption, as I said we were about $17 million in total; most of which was Fairfax. There were a couple of other insurance recoverable events that we were collecting on the second quarter, total $17 million; Fairfax most of that. And that was really, as it ended up, the bulk of the business interruption collections for the rest of the year. We took in about another $5 million over the course of the third and fourth quarters last year.

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

Q

Okay, that's helpful. And then maybe on the 91st Street, how should we think about the EBITDA multiple on the $35 million of capital deployed?

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

A

It'll be about a 5 times multiple, if you want to look at it that way.

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

Okay.

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

5 or less.

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

Okay, that's helpful. And then, Steve, any update on the TAPS project?

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

Yeah. Actually Pennsylvania issued the umbrella permit under which we'll now file for our increase to kind of activities at Fairless Hills, which will include the TAPS project. So we'll put that permit in shortly. We're working with our vendor who's providing the equipment and technology setup. They're doing some work at their site to kind of modularize the equipment. So we still think we're firmly on target for kind of the first quarter or next year of operation, so things are going well there. We were waiting, quite frankly, for Pennsylvania to kind of describe how they would like to see the permit from us, and they've done that now and we'll be moving ahead.

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

Okay. Just a quick clarification, but is the $25 million, that is not in the current growth investment outlook?

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

No, no it's not. And most of it – this'll be back end-loaded in this year anyway because we'll do some work. But mostly we'll wait for the permit to process through Pennsylvania, so we're looking at later 2018, kind of early 2019 for most of the spend.

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

Yeah. I'll tell you, Tyler, the approach we've taken on the growth investment outlook for this year, and Rookery as I mentioned is a similar one where...

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

Right.

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

...whenever there's timing uncertainty related in particular to regulatory approvals, rather than be shooting at a moving target all year we just flag what's out there. And once we have certainty, we'll formally incorporate it into the forecast.

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

Q

Yeah, perfect. No, I just want to make sure I had that. Okay. Thanks, guys.

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

A

Yeah, sure.

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

Noah Kaye
Analyst, Oppenheimer & Co., Inc.

Q

Good morning, gentlemen. Thanks for taking the question.

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

A

Good morning.

Noah Kaye
Analyst, Oppenheimer & Co., Inc.

Q

Thank you. Maybe we can start with profiled waste. Just so we can kind of understand operationally, you talked about expectations for double-digit growth again this year, profiled waste revenue growing 1% in the quarter but it accelerates. Just operationally, what's going on to kind of increase the flow of that profiled waste kind of given the startup at Fairfax? It would be just helpful to understand maybe the reason for the cadence over the course of the year.

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

A

Yeah. Noah, that's a good question. Our ramp, quite frankly, was a bit slower than I would've liked, and a lot of this relates to Fairfax. As we mentioned last year, Fairfax is a big profiled waste plant. So now that's onstream, part of our efforts are reacquiring the waste that went to other places. But there was a couple other things that happened particularly in this quarter. Some of the weather issues given the significant snowfall throughout the serviced area in the first quarter had an impact on us. There was less event work also in Q1 than last year so that also had an impact. Usually, if we do event work, Noah, we'll get more access to profiled waste but we're pretty comfortable as we look out through the rest of the year that this will ramp up fairly quickly.

I mentioned the two areas that also play in the profiled waste which is the kind of drug take-back programs that you're seeing a lot more momentum now in the U.S. around because of the opioid crisis. And although the volumes aren't large right now, we won the first New York City or New York State RFP around drug take-back program, so that'll start to roll in. And then also, the regulated medical waste permit that we got at one of our facilities, which is the third one we have now, allows us to be the largest receiver of regulated medical waste, so we will go out and try to pick up regulated medical waste as a disposal option. And because we have the thermal treatment, because of the heat levels in our plant, we're able to take certain types of regulated medical waste. So that'll all – as we get into that permit and working out the logistics on that plant, that'll all feed into the profiled waste program as we go through this year. So I'm pretty comfortable we will be hitting the double-digit numbers that we talked about.

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Noah Kaye
Analyst, Oppenheimer & Co., Inc.

Q

Right, right, very good. And then you touched on developments with Rookery and the UK pipeline. Understanding the claim was filed quite recently, what's your understanding of the next step in the process there? And maybe how should we think about a reasonable expectation of the timeframe for that to get resolved and to be able to enter full scale construction?

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

A

Yeah, sure. Well first of all, I want to make it clear. We don't think the claim has any merit and I think it will fail. And so in the meantime we'll be continuing to develop the project, so we have construction going on at the site already; I think I mentioned that on the last call, and so continuing that work. The one area that's impacted is really project financial close. And so we'll look at, with our partners, both Veolia and GIG, we'll look at the schedule under which this claim is reviewed. And the delay could be anywhere from a few weeks, potentially to a few months, but it's kind of early to assess. Like I mentioned, we're hearing it from some social media so we haven't received anything yet; it's kind of a social media event at this point.

We're confident that the UK Environment Agency led a very robust process. So they had two consultation periods, both of which were extended to allow incremental feedback, and all the questions were answered by the environmental agency. And the claim is really on, just to give people an idea, the claims really has to be on the process held by the environmental agency, and we think that they went through a pretty rigorous process. And under the UK system, the loser of the suit has to pay for the cost. So this is a local opposition group, so I think that becomes a bit of a challenge. So as I said, we're confident that the claim doesn't have any merit and the Environment Agency is going to vigorously defend their process, and I think they'll ultimately prevail in the effort. As I mentioned on timing, it's a little early to tell what that means. But like I said, anywhere from a few weeks to potentially a few months.

Noah Kaye
Analyst, Oppenheimer & Co., Inc.

Q

Yeah, that's very helpful. And again, just so we understand, I mean, this is a project that could come online several years in the future, right?

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

A

Right.

Noah Kaye
Analyst, Oppenheimer & Co., Inc.

Q

And you're still proceeding and this is a process challenge, not a challenge to the merits of the permit itself?

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

A

That's exactly right.

Noah Kaye
Analyst, Oppenheimer & Co., Inc.

Q

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So it seems like there's a possibility, just looking at the review process, there could be a reply in a couple of weeks or even sooner. Again, I have no legal background but I know there are folks in your team that do. So just as long as we all understand that.

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

A

Yeah, that's correct. It's a challenge on the process that the Environment Agency in the UK utilize. And realize that they're set up to – they go through these types of processes all the time, so they're very good at the process around granting me this operating our waste permit. So we're pretty confident.

Noah Kaye
Analyst, Oppenheimer & Co., Inc.

Q

Really appreciate it. Thank you.

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

A

Thanks, Noah.

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

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

Q

Thank you, Steve, Brad, and Dan – and Dan, I hope you're feeling better – for taking my questions. Recycling, I'm curious, we recently were at Expo and had Jim Warner on a panel and asked if he had started seeing any, first of all, what volume conditions look like and these are the two plants you operate. But he made two comments I thought were interesting. One, they have plenty of trash; there's lots of volume. So I'm curious about what that's doing to the spot market from that? But the second was, was he seeing any of the impact of the Chinese ban on mixed waste paper. Has it finally moved out of warehouses and either going into landfills or coming to incinerators and I was curious what you're seeing across your portfolio?

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

A

Yeah. So this is interesting. I had a text from a friend of mine yesterday that has a warehouse that has a lot of plastic in it. And he said, hey, can you guys take this plastic? We don't want to put it into a landfill; we want to take it to an Energy-from-Waste plant. And we're starting to get some of those questions throughout our fleet. So at this stage, it's a little early to tell how all this plays out. I think, ultimately, it means that there's going to be more waste in the waste sheds across the U.S. and other countries too. I mean, we've heard a little bit about this in the UK from some of our UK partners. They're having issues too. Our preference is not to take the materials because it has the, as you well know, has the higher energy content; this isn't plastics in particular.

So we believe the best outcome for this to kind of sort itself out and maybe – and I know you and I have talked about this before, Michael. Maybe the Chinese will change some of their regulations there. They often will do that. Obstruct that 1 one path and then kind of head in another direction. So we'll have to see how this all plays out, but it's certainly, in our view, leading to kind of more waste out there.

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Waste markets continue to be strong. Pricing has been strong especially in New England, and you and I've talked about that before. Pricing is strong in the profiled waste markets. Our merchant plants and our transfer stations continue to be full, and so we're pushing spot prices. And so, as a general matter, it's a good time to be a waste company. I think the markets are pretty darn good right now, and the China situation is just adding more waste into the waste shed.

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

Okay. Switching gears, I just want to make sure I'm following the path right to how I think about the model. If it's $100 million in 1Q, you reaffirmed at the midpoint at $440 million as the EBITDA. But given all the puts and takes you shared with us about things that do and don't repeat or changes in profile like hedging at $50 in 1Q comes down in 2Q and 3Q, we should assume to model down EBITDA sequentially. That's not bad news; just let's make sure we follow the pattern, right? As $100 million goes down and then it comes up again in the second half, that's the way to think about it, right?

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

Yeah. I think that's right. And obviously the second half is always the stronger period in the third quarter in particular, which everyone knows. I think second quarter, and we don't give obviously precise guidance on the quarters, but I think your characterization is broadly accurate and it should be relatively consistent with the first quarter with maybe a bit of downward pressure. I think that's fair.

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

And to think you're reaffirming the $33 in your notes in the PowerPoint. So to get to the $33, I've got to drop down somewhere in the $25 to $35 range versus the $50 in the first to be able to make that work...?

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

On power? Yes. Yes, that's right.

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

That's correct.

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

Yeah, okay. I wanted to make sure I follow that logic right. And then just remind me, so all of this noise around Rookery passes, you get your project financing lined up. It's approximately 90% of what you spent on Dublin. How does that show up on the balance sheet again now that the joint venture exists?

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

Yeah. So really our only interest in the projects to the joint venture are going to be, in this quarter, it's in other assets, it's in the equity and in unconsolidated subsidiaries. So no debt on our balance sheet.

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

So when Rookery starts financing, none of that debt shows up on the balance sheet?

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

That's correct.

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

Okay. I just wanted to make sure I remember that correctly. All right, terrific. Thanks.

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

Thanks, Michael.

Operator: [Operator Instructions] Your next question comes from Jeff Silber of BMO Capital Markets. Your line is open.

Jeffrey Marc Silber
Analyst, BMO Capital Markets (United States)
Q

Thank you so much. I'm going to pass along a question I got from a few investors. I know it's early, but you had sizable outperformance in the first quarter. Was there any reason or did you consider raising guidance for the year or are you just being overly conservative?

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

It's still early in the year. Listen, I'm really pleased with the first quarter. As I mentioned, I think it sets us up nicely for the year. But it's only been about 50 days since we gave guidance initially, so we thought let's see how the rest of the year starts to play out. So that was really more of our thinking.

Jeffrey Marc Silber
Analyst, BMO Capital Markets (United States)
Q

Okay. Fair enough.

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

I don't know, Brad, if you want to – Brad might want to comment.

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

Yeah. I'd just emphasize, going back to our description of operations in the first quarter, I mean, frankly the plants operated the way they should and the way we typically expect them to and the way that we assumed they would in our guidance. So there was nothing really extraordinary in that regard. I think the first quarter, candidly, we benefited from – unfortunately, as relates to last year – a pretty favorable comp.

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Jeffrey Marc Silber
Analyst, BMO Capital Markets (United States)

Q

Okay. And then drilling a bit further into the waste segment. In slide number 4, when you talk about trends and outlooks, you talk about further increases in waste processing value. Does that imply accelerating growth or are you just looking for growth to stay stable from what we saw in the first quarter?

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

A

To the extent – it refers to processing volume. Now, of course, our capacity is relatively fixed. And then with Fairfax operating for a full year and at now record levels, with Dublin operating characterized now as essentially a service fee arrangement for us. With added capacity you're going to see higher processing volumes. But beyond that, necessarily this is an ongoing rate of growth.

Jeffrey Marc Silber
Analyst, BMO Capital Markets (United States)

Q

Okay. On the pricing side, I'm sorry, you talk about acceleration. If we can just get a little bit of color on that, maybe quantify that if possible. Thanks.

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

A

Yeah, sorry. So we saw same-store price growth year-over-year in the first quarter of 2%. We talked last quarter about our expectation for the year for that to be in the neighborhood of 3%, and we still have that view. So that implies an acceleration.

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

A

Yeah. We feel pretty good about our 3% number. As you go through like – as I mentioned, Jeff, profiled waste didn't meet my expectations in the first quarter. It's going to accelerate as you go through the year and that pricing on the profiled waste is pretty darn good and that'll kind of carry us up from the 2% up to the 3%, along with, as Michael asked, along with just kind of overall good waste market dynamics at this point.

Jeffrey Marc Silber
Analyst, BMO Capital Markets (United States)

Q

Okay. That's really helpful. Thanks so much.

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

A

Yes.

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

Brian Lee
Analyst, Goldman Sachs & Co. LLC

Q

Hey, guys. Thanks for taking the questions.

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

Hey, Brian.

Brian Lee
Analyst, Goldman Sachs & Co. LLC
Q

Hey, good morning. And just to follow-up on the pricing point. I know you guys don't always think about it this way, but when we look at – from a modeling perspective – you had the contracted revenue per ton on contracted versus uncontracted streams. It's the first time in a while where I think we've seen the ASPs up year-on-year in the contracted and then uncontracted being down year-on-year. I'm sure there's some moving pieces embedded in that given the partial recognition of Dublin, but can you speak to some of the dynamics that drove that for this quarter? And then I know you talked to some of the general pricing trends same-store here. But what would you say we should be thinking about for those two-way streams as you report them pricing-wise moving through the year?

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

Hey, Brian, it's Brad. Yeah, I think you've touched on it. I mean, there is a mix issue going on in the averages, so Dublin being included as part of it. And then the pricing that we focus on in our disclosures now is on tip fee structure plants having owned Dublin 100% consolidated, Dublin 100% for half of the quarter, and the tip fees being much, much higher at Dublin than anything in the domestic portfolio that had a meaningful, actually even for half the quarter, had a meaningful mix impact. Going the other way was, of course, Fairfax coming back on is a great story and is a big contributor, but it's actually below average just given the market it's in; it's below average on tip fee. So that, for both contracted and uncontracted, kind of weighs it the other way. So you do have some churn underneath the surface. But I think the key numbers that we try to focus on is on a same-store basis we see consistent growth, whether it's across the contracts which generally are escalating with inflation which we now finally see upward pressure on, and then of course the uncontracted in the spot market and for profiled waste where we see strong and probably improving, if anything, dynamics going forward.

Brian Lee
Analyst, Goldman Sachs & Co. LLC
Q

Okay, fair enough. But would you characterize it as mix still being a bit of a headwind into 2Q and then things normalize as we get into the back half of the year?

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

Yeah.

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

Yeah, that's probably right.

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

That's a fair way to look at it because Dublin comes out and of course Fairfax year-over-year is going to be a mix on a comparable basis all the way through the year. So, yes.

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Brian Lee
Analyst, Goldman Sachs & Co. LLC

Q

Okay, that's helpful. And then just a second one for me and I'll pass it on. With respect to the metals business, you're not making any changes to the pricing assumptions here despite having raised the HMS outlook and also the strength that we're seeing here more recently. So is it fair to assume on the ranges that you're tracking toward the higher end and you just didn't want to tighten the range or raise this early on in the year? Just wondering how to interpret the updated view on HMS strength and no change to your ferrous outlook. Thanks.

Brian Lee
Analyst, Goldman Sachs & Co. LLC

Q

That's a fair comment, Brian. If you look at where – as I mentioned in my prepared remarks, we're in the $350 range right now on HMS 1. Copper prices are really good. One of the reasons we're being a little cautious here is because of any potential retaliation associated with the Section 232 tariffs. So we're not really sure how this is all going to play out, so we thought we'd move up the HMS range based on what we've seen but we're being a little cautious at this point; we'll see. As we go through the year and see how all this plays out and whether there's issues that come back from China and their retaliation, it'll become clear. Realize too that most of our metals are actually sold in the U.S. There are some that are non-ferrous, a portion of our over, so the bigger non-ferrous pieces go to China, but there's also other markets around the world. So again, the markets may move around a little bit depending on what happens. I don't think we'll be severely impacted or seriously impacted. But like I said, we're kind of wait and see at this point to see what happens through the next quarter.

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

A

And Brian, there's also a little nuance here that's impacting this as well, and it's on the ferrous side in some circumstances where historically we have delivered product to the end delivery point. By doing that, we incur transportation cost and charge a higher revenue per ton effectively. We, in some cases, have been entering into arrangements that are FOB the door of our plant, i.e. the offtaker takes control of the material at our plant. So we're not incurring the transportation costs anymore but revenue comes down. So long story short, that's a situation where the revenue doesn't necessarily tell the whole story.

Brian Lee
Analyst, Goldman Sachs & Co. LLC

Q

Okay. No, that's helpful color. Last one for me, just a follow-up here. Is that shipping issue, sort of what you're budgeting for potential Section 232 retaliation, playing in at all to the slight volume downticks on both ferrous and non-ferrous on your outlook for 2018? I might've missed that, but what were the drivers behind the downticks there?

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

A

Yeah. There's another nuance here that you've kind of picked up on which is we have changed the accounting for the way that the Dublin ash and metals will be handled where we had provided our initial full year guidance assuming that we book revenue for the sale of metals. The approach in Dublin, and this is consistent with the way it's done primarily in the UK as well, is the metal sales are effectively netted against your ash costs. So we've decided to change to we think a more appropriate accounting treatment in Dublin's case where the metals revenue is netted against cost. So again, we get the benefit elsewhere. But in terms of our statistics for the tons

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sold that generate revenue, they came out of the number. On non-ferrous, we adjusted it slightly just based on volume processed at the centralized processing facility and just the timing of some recovery projects.

Brian Lee
Analyst, Goldman Sachs & Co. LLC

Q

All right. Thanks, guys.

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

A

Sure. Thanks, Brian.

Operator: There are no further questions at this time. I will now return the call to Steve Jones for final comments.

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

Thanks, everyone, for taking the time to talk about our company. We're excited about the first quarter and as the year goes on. And we appreciate – we know you're all very busy, it's earning season, and we appreciate taking the time to share your questions with us and talk about where Covanta is headed. So thanks and have a good day and a good weekend. Take care.

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

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