COVANTA HOLDING CORP
Form 10-Q
October 26, 2016
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q
þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2016
or
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission file number 1-06732
COVANTA HOLDING CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	95-6021257
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification Number)

445 South Street, Morristown, NJ	07960
(Address of Principal Executive Office)	(Zip Code)

(862) 345-5000
(Registrant’s telephone number including area code)
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ	Accelerated filer ¨	Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No þ
Applicable Only to Corporate Issuers:
Indicate the number of shares of the registrant’s Common Stock outstanding as of the latest practicable date.

Class	Outstanding at October 21, 2016
Common Stock, $0.10 par value	130,415,290

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COVANTA HOLDING CORPORATION AND SUBSIDIARIES
FORM 10-Q QUARTERLY REPORT
For the Quarter Ended September 30, 2016

PART I. FINANCIAL INFORMATION

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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This report contains “forward-looking statements” within the meaning of Section 21E of the Securities Exchange Act of 1934. Forward-looking statements are those that address activities, events or developments that we or our management intends, expects, projects, believes or anticipates will or may occur in the future. They are based on management’s assumptions and assessments in the light of past experience and trends, current economic and industry conditions, expected future developments and other relevant factors. They are not guarantees of future performance, and actual results, developments and business decisions may differ from those envisaged by our forward-looking statements. Our forward-looking statements are also subject to risks and uncertainties, which can affect our performance in both the near- and long-term. These forward-looking statements should be considered in the light of the information included in this report and our other filings with the Securities and Exchange Commission, including, without limitation, the Risk Factors, as well as the description of trends and other factors in Management’s Discussion and Analysis of Financial Condition and Results of Operations, set forth in our 2015 Annual Report on Form 10-K.

PART I. FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS
COVANTA HOLDING CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(Unaudited)			
	(In millions, except per share amounts)			
OPERATING REVENUE:				
Waste and service revenue	$299	$283	$875	$805
Energy revenue	92	108	279	319
Recycled metals revenue	14	16	44	49
Other operating revenue	16	15	44	40
Total operating revenue	421	422	1,242	1,213
OPERATING EXPENSE:				
Plant operating expense	272	260	901	849
Other operating expense	14	18	45	55
General and administrative expense	23	20	71	71
Depreciation and amortization expense	52	50	155	148
Impairment charges	—	—	19	24
Total operating expense	361	348	1,191	1,147
Operating income	60	74	51	66
Other income (expense):				
Interest expense, net	(35)	(34)	(103)	(102)
Gain on asset sales	43	—	43	—
Loss on extinguishment of debt	—	—	—	(2)
Other expense, net	(1)	—	(1)	(1)
Total other income (expense)	7	(34)	(61)	(105)
Income (loss) before income tax (expense) benefit and equity in net (loss) income from unconsolidated investments	67	40	(10)	(39)
Income tax (expense) benefit	(12)	(11)	(5)	19
Equity in net (loss) income from unconsolidated investments	(1)	5	3	11
NET INCOME (LOSS) ATTRIBUTABLE TO COVANTA HOLDING CORPORATION	$54	$34	$(12)	$(9)
Weighted Average Common Shares Outstanding:				
Basic	129	132	129	132
Diluted	131	134	129	132
Income (Loss) Per Share Attributable to Covanta Holding Corporation Stockholders:				
Basic	$0.42	$0.26	$(0.09)	$(0.07)
Diluted	$0.42	$0.25	$(0.09)	$(0.07)
Cash Dividend Declared Per Share:	$0.25	$0.25	$0.75	$0.75

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

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COVANTA HOLDING CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(Unaudited) (In millions)			
Net income (loss) attributable to Covanta Holding Corporation	$54	$34	$(12)	$(9)
Foreign currency translation	(5)	(5)	1	(14)
Net unrealized (loss) gain on derivative instruments, net of tax expense(benefit) of $1, $1, $(4) and $3, respectively	—	—	(20)	6
Other comprehensive loss attributable to Covanta Holding Corporation	(5)	(5)	(19)	(8)
Comprehensive income (loss) attributable to Covanta Holding Corporation	$49	$29	$(31)	$(17)

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

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COVANTA HOLDING CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

	September 30, 2016 (Unaudited)	December 31, 2015
	(In millions, except per share amounts)	
ASSETS		
Current:		
Cash and cash equivalents	$ 113	$ 94
Restricted funds held in trust	62	77
Receivables (less allowances of $9 million and $7 million, respectively)	299	312
Prepaid expenses and other current assets	73	114
Assets held for sale	—	97
Total Current Assets	547	694
Property, plant and equipment, net	2,997	2,690
Restricted funds held in trust	57	83
Waste, service and energy contracts, net	269	284
Other intangible assets, net	35	38
Goodwill	303	301
Other assets	67	121
Total Assets	$ 4,275	$ 4,211
LIABILITIES AND EQUITY		
Current:		
Current portion of long-term debt	$ 9	$ 8
Current portion of project debt	23	16
Accounts payable	52	90
Accrued expenses and other current liabilities	234	234
Liabilities held for sale	—	23
Total Current Liabilities	318	371
Long-term debt	2,286	2,255
Project debt	381	159
Deferred income taxes	595	595
Waste and service contracts, net	8	13
Other liabilities	187	178
Total Liabilities	3,775	3,571
Commitments and Contingencies (Note 12)		
Equity:		
Covanta Holding Corporation stockholders equity:		
Preferred stock ($0.10 par value; authorized 10 shares; none issued and outstanding)	—	—
Common stock ($0.10 par value; authorized 250 shares; issued 136 shares, outstanding 130 and 131, respectively)	14	14
Additional paid-in capital	804	801
Accumulated other comprehensive loss	(53)	(34)
Accumulated deficit	(264)	(143)
Treasury stock, at par	(1)	—
Total Covanta Holding Corporation stockholders' equity	500	638
Noncontrolling interests in subsidiaries	—	2

Total Equity	500	640
Total Liabilities and Equity	$ 4,275	$ 4,211

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

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COVANTA HOLDING CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOW

	For the Nine Months Ended September 30,	
	2016	2015
	(Unaudited, in millions)	
OPERATING ACTIVITIES:		
Net loss	$(12)	$(9)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization expense	155	148
Amortization of long-term debt deferred financing costs	5	6
Gain on asset sales	(43)	—
Impairment charges	19	24
Loss on extinguishment of debt	—	2
Stock-based compensation expense	13	15
Equity in net income from unconsolidated investments	(3)	(11)
Dividends from unconsolidated investments	2	3
Deferred income taxes	3	(22)
Other, net	(3)	—
Change in restricted funds held in trust	22	14
Change in working capital	(12)	(16)
Net cash provided by operating activities	146	154
INVESTING ACTIVITIES:		
Purchase of property, plant and equipment	(282)	(267)
Acquisition of businesses, net of cash acquired	(9)	(70)
Proceeds from asset sales	107	—
Property insurance proceeds	2	—
Other, net	4	—
Net cash used in investing activities	(178)	(337)
FINANCING ACTIVITIES:		
Proceeds from borrowings on long-term debt	—	294
Proceeds from borrowings on revolving credit facility	658	655
Proceeds from equipment financing capital leases	—	15
Proceeds from borrowings on project debt	—	59
Proceeds from borrowings on Dublin project financing	139	85
Payments on long-term debt	(2)	(196)
Payments of borrowings on revolving credit facility	(623)	(509)
Payments on equipment financing capital leases	(3)	(3)
Payments on project debt	(17)	(63)
Payments of deferred financing costs	(5)	(8)
Cash dividends paid to stockholders	(98)	(100)
Change in restricted funds held in trust	19	(62)
Common stock repurchased	(20)	—
Net cash provided by financing activities	48	167

Effect of exchange rate changes on cash and cash equivalents	1	(4)
Net increase (decrease) in cash and cash equivalents	17	(20)
Cash and cash equivalents at beginning of period	96	91
Cash and cash equivalents at end of period	113	71
Less: Cash and cash equivalents of assets held for sale at end of period	—	2
Cash and cash equivalents of continuing operations at end of period	$113	$69

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

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

NOTE 1. ORGANIZATION AND BASIS OF PRESENTATION

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

Organization

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

Our EfW facilities earn revenue from both the disposal of waste and the generation of electricity and/or steam, generally under contracts, as well as from the sale of metal recovered during the EfW process. We process approximately 20 million tons of solid waste annually. We operate and/or have ownership positions in 42 energy-from-waste facilities, which are primarily located in North America. In total, these assets produce approximately 10 million megawatt hours (“MWh”) of baseload electricity annually. We also operate a waste management infrastructure that is complementary to our core EfW business.

We have one reportable segment, North America, which is comprised of waste and energy services operations located primarily in the United States and Canada. We are currently constructing an energy-from-waste facility in Dublin, Ireland, which we own and will operate upon completion. We hold equity interests in China and Italy.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with United States Generally Accepted Accounting Principles (“GAAP”) and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all information and notes thereto required by GAAP for complete consolidated financial statements. In the opinion of management, all adjustments (including normal recurring accruals) considered necessary for fair presentation have been included in our condensed consolidated financial statements. All intra-entity accounts and transactions have been eliminated. Operating results for the interim period are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2016. This Form 10-Q should be read in conjunction with the Audited Consolidated Financial Statements and accompanying Notes in our Annual Report on Form 10-K for the year ended December 31, 2015 (“Form 10-K”).

Reclassification

During the nine months ended September 30, 2016, certain amounts have been reclassified in our prior period balance sheet and cash flows to conform to current year presentation and such amounts were not material to current and prior periods. We concluded that it was appropriate to include Net interest expense on project debt within Interest expense, net on our consolidated statement of operations. Previously, Net interest expense on project debt was reported separately, as a component of Operating expense. For the three and nine months ended September 30, 2015, Net interest expense on project debt of $3 million and $10 million, respectively, was included in Interest expense, net on our condensed consolidated statement of operations and as a result, Operating income increased accordingly for those periods.

Change in Accounting Principle

Effective January 1, 2016, we adopted guidance concerning the presentation of debt issuance costs, which are required to be presented as a direct reduction from the carrying amount of the related debt liability. We adopted this guidance retrospectively, which resulted in a reduction in our December 31, 2015 current and non-current asset balances of $8 million and $40 million, respectively, along with a corresponding reduction in current and long-term debt balances. For additional information, see Note 6. Consolidated Debt.

NOTE 2. RECENT ACCOUNTING PRONOUNCEMENTS

In August 2016, the Financial Accounting Standards Board ("FASB") issued updated guidance on eight specific cash flow issues with regard to how cash receipts and cash payments are presented and classified in the statement of cash flows in order to clarify existing guidance and reduce diversity in practice. The guidance is required to be adopted in the first quarter of 2018 on a retrospective basis, unless it is impracticable to apply, in which case it should be applied prospectively as of the earliest date practicable. Early adoption is permitted. We are currently evaluating the impact this guidance will have on our consolidated statement of cash flows.

In March 2016, the FASB issued amended guidance for employee share-based compensation. The updated guidance changes how companies account for certain aspects of share-based payment awards to employees, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. The guidance, which is required to be adopted in the first quarter of 2017, may be early adopted. We are currently evaluating the impact this guidance will have on our consolidated financial statements.

In February 2016, the FASB issued amended guidance for lease arrangements in order to increase transparency and comparability by providing additional information to users of financial statements regarding an entity's leasing activities. The revised guidance seeks to achieve this objective by requiring reporting entities to recognize lease assets and lease liabilities on the balance sheet for substantially all lease arrangements. The guidance, which is required to be adopted in the first quarter of 2019, will be applied on a modified retrospective basis beginning with the earliest period presented. Early adoption is permitted. We are currently evaluating the impact of adopting this guidance on our consolidated financial statements.

In January 2016, the FASB issued accounting guidance that would require equity investments not accounted for as an equity method investment or that result in consolidation to be recorded at their fair value with changes in fair value recognized in our consolidated statements of operations. Those equity investments that do not have a readily determinable fair value may be measured at cost less impairment, if any, plus or minus changes resulting from observable price changes. This standard is required to be adopted in the first quarter of 2018, with early adoption prohibited. We are currently evaluating the impact this guidance will have on our consolidated financial statements and related disclosures.

In May 2014, the FASB issued guidance based on the principle that revenue is recognized in an amount expected to be collected and to which the entity expects to be entitled in exchange for the transfer of goods or services. In August 2015, the FASB deferred the effective date by one year to January 1, 2018, while providing the option to early adopt the standard on the original effective date of January 1, 2017. We do not intend to early adopt. We will first adopt the guidance of ASC606 in the first quarter of 2018, as required. The guidance can be adopted either retrospectively or as a cumulative-effect adjustment as of the date of adoption. We are currently evaluating the adoption alternatives, which include utilizing a bottom-up approach to analyze the standard’s impact on our contract portfolio, comparing historical accounting policies and practices to the new standard to identify potential differences from applying the requirements of the new standard to our contracts. We have not yet selected a transition method nor have we yet determined the effect of the standard on our consolidated financial statements. We expect this determination will near completion in late 2016 or early 2017. Because the new standard will impact our business processes, systems and controls, we are in the process of developing a comprehensive change management project plan to guide the implementation.

NOTE 3. DISPOSITIONS AND OTHER

China Investments

Our interests in China included an 85% ownership of an EfW facility located in Jiangsu Province ("Taixing"), a 49% equity interest in an EfW facility located in Sichuan Province and a 40% equity interest in Chongqing Sanfeng Covanta Environmental Industry Co., a company located in the Chongqing Municipality that is engaged in the business of providing design and engineering, procurement, construction services and equipment sales for EfW facilities in China, as well as operating services for EfW facilities.

During March 2016, we completed the exchange of our ownership interests in China for a 15% ownership interest in Chongqing Sanfeng Covanta Environmental Industrial Group, Co., Ltd ("Sanfeng Environment") pursuant to agreements entered into in July 2015. During September 2016, we completed the sale of approximately 90% of the aforementioned ownership interest in Sanfeng Environment to a third-party, a subsidiary of CITIC Limited ("CITIC"), a leading Chinese industrial conglomerate and investment company, pursuant to the July 2015 agreements. As a result, during the three months ended September 30, 2016, we recorded a pre-tax gain of $41 million. We received pre-tax proceeds of $105 million. The gain resulted from the excess of pre-tax proceeds over the cost-method book value of $70 million, plus $5 million of realized gains on the related cumulative foreign currency translation adjustment, that were reclassified out of other comprehensive income.

In connection with these transactions, we entered into foreign currency exchange collars and forwards to hedge against rate fluctuations that impacted the cash proceeds in U.S. dollar terms. For more information, see Note 11. Derivative Instruments.

As of September 30, 2016, our remaining cost-method investment in Sanfeng Environment totaled $7 million and was included in our condensed consolidated balance sheet as a component of "Other assets". Cost-method investments are carried at historical cost unless indicators of impairment are identified. There were no impairment indicators related to our cost-method investment during the nine months ended September 30, 2016. As of December 31, 2015, the assets and liabilities associated with our China investments were presented in our condensed consolidated balance sheets as Current "Assets held for sale” and Current "Liabilities held for sale.”

Pittsfield EfW Facility

In March 2016, we exercised an early termination option available under the steam sale agreement at our Pittsfield EfW facility that would have been effective in March 2017. Upon termination of the steam agreement, we intended to cease operations at the Pittsfield facility. As a result, during the first quarter of 2016, we recorded a non-cash impairment charge of $13 million, pre-tax, which was calculated based on the estimated cash flows for this facility during its remaining operations utilizing Level 3 inputs. For more information regarding fair value measurements, see Note 10. Financial Instruments.

In October 2016, we withdrew our termination notice. The City of Pittsfield has agreed to fund upgrades to the facility and the State of Massachusetts will provide energy tax credits, both of which will serve to improve the economics of the facility. In addition, we will continue to sell steam generated by the facility under an amended agreement.

Tartech Investment

We are party to a joint venture that was formed to recover and recycle metals from EfW ash monofills in North America. During the nine months ended September 30, 2016, due to operational difficulties and the decline in the scrap metal market, a valuation of the entity was conducted. As a result, we recorded a net impairment of our investment in this joint venture of $3 million, pre-tax, which represents our portion of the carrying value of the entity in excess of the fair value. Such amount was calculated based on the estimated liquidation value of the tangible equipment utilizing Level 3 inputs. For more information regarding fair value measurements, see Note 10. Financial Instruments.

NOTE 4. EARNINGS PER SHARE (“EPS”) AND EQUITY

Earnings Per Share

We calculate basic earnings per share ("EPS") using net earnings for the period and the weighted average number of outstanding shares of our common stock, par value $0.10 per share, during the period. Basic weighted average shares outstanding have decreased due to share repurchases. Diluted earnings per share computations, as calculated under the treasury stock method, include the weighted average number of shares of additional outstanding common stock issuable for stock options, restricted stock awards and restricted stock units whether or not currently exercisable. Diluted earnings per share does not include securities if their effect was anti-dilutive. Basic and diluted weighted average shares outstanding were as follows (in millions):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Basic weighted average common shares outstanding	129	132	129	132
Dilutive effect of stock options, restricted stock and restricted stock units [1]	2	2	—	—
Diluted weighted average common shares outstanding	131	134	129	132

(1) Excludes the following securities because their inclusion would have been anti-dilutive:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Stock options	1	1	1	1
Restricted stock	—	—	1	—

Restricted stock units	—	—	1	1

Equity

Share Repurchases

In January 2016, we repurchased approximately 1.2 million shares of our common stock at a weighted average cost of $15.29 per share for an aggregate amount of $18 million.

Dividends per Share

Dividends declared per share were $0.25 for each of the three-month periods ended September 30, 2016 and 2015 and $0.75 for each of the nine month periods ended September 30, 2016 and 2015. Cash dividends declared were $33 million and $34 million for the three month periods ended September 30, 2016 and 2015, respectively and $99 million and $101 million for the nine month periods ended September 30, 2016 and 2015, respectively.

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COVANTA HOLDING CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED FINANCIAL STATEMENTS (UNAUDITED) - (Continued)

Accumulated Other Comprehensive Income (Loss) ("AOCI")
The changes in accumulated other comprehensive loss are as follows (in millions):

	Foreign Currency Translation	Pension and Other Postretirement Plan Unrecognized Net Gain	Net Unrealized (Loss) Gain on Derivatives	Net Unrealized Gain on Securities	Total
Balance December 31, 2014	$ (12)	$ 2	$ (12)	$ —	$ (22)
Other comprehensive (loss) income before reclassifications	(14)	—	6	—	(8)
Amounts reclassified from accumulated other comprehensive loss	—	—	—	—	—
Net current period comprehensive (loss) income	(14)	—	6	—	(8)
Balance September 30, 2015	$ (26)	$ 2	$ (6)	$ —	$ (30)
Balance December 31, 2015	$ (34)	$ 2	$ (2)	$ —	$ (34)
Other comprehensive income (loss) before reclassifications	6	—	(20)	—	(14)
Amounts reclassified from accumulated other comprehensive loss	(5)	—	—	—	(5)
Net current period comprehensive income (loss)	1	—	(20)	—	(19)
Balance September 30, 2016	$ (33)	$ 2	$ (22)	$ —	$ (53)

Amount Reclassified from Accumulated Other Comprehensive Income

Accumulated Other Comprehensive Income Component	Nine Months Ended September 30, 2016	Affected Line Item in the Consolidated Statement of Operations
Foreign currency translation	$ 5	Gain on asset sales
	5	Total before tax
	—	Tax benefit
Total reclassifications	$ 5	Net of tax

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COVANTA HOLDING CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED FINANCIAL STATEMENTS (UNAUDITED) - (Continued)

NOTE 5. FINANCIAL INFORMATION BY BUSINESS SEGMENTS

We have one reportable segment, North America, which is comprised of waste and energy services operations located primarily in the United States and Canada. The results of our reportable segment are as follows (in millions):

	North America	All Other (1)	Total
Three Months Ended September 30, 2016			
Operating revenue	$ 421	$ —	$ 421
Depreciation and amortization expense	52	—	52
Impairment charges	—	—	—
Operating income (loss)	62	(2)	60
Three Months Ended September 30, 2015			
Operating revenue	$ 411	$ 11	$ 422
Depreciation and amortization expense	52	(2)	50
Impairment charges	—	—	—
Operating income	71	3	74

	North America	All Other (1)	Total
Nine Months Ended September 30, 2016			
Operating revenue	$ 1,235	$ 7	$ 1,242
Depreciation and amortization expense	155	—	155
Impairment charges	19	—	19
Operating income (loss)	55	(4)	51
Nine Months Ended September 30, 2015			
Operating revenue	$ 1,184	$ 29	$ 1,213
Depreciation and amortization expense	147	1	148
Impairment charges	24	—	24
Operating income	66	—	66

(1) All other is comprised of the financial results of our operations outside of North America.

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COVANTA HOLDING CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED FINANCIAL STATEMENTS (UNAUDITED) - (Continued)

NOTE 6. CONSOLIDATED DEBT
Consolidated debt is as follows (in millions):

	As of September 30, 2016	December 31, 2015
LONG-TERM DEBT:		
Revolving credit facility (2.95% - 3.20%)(1)	$384	$ 348
Term loan, net (2.45%)	198	200
Credit Facilities Sub-total	$582	$ 548
7.25% Senior notes due 2020	$400	$ 400
6.375% Senior notes due 2022	400	400
5.875% Senior notes due 2024	400	400
Less: deferred financing costs related to senior notes	(15)	(16)
Senior Notes Sub-total	$1,185	$ 1,184
4.00% - 5.25% Tax-exempt bonds due 2024 through 2045	$464	$ 464
Less: deferred financing costs related to tax-exempt bonds	(5)	(6)
Tax-Exempt Bonds Sub-total	$459	$ 458
3.48% - 4.52% Equipment financing capital leases due 2024 through 2027	$69	$ 73
Total long-term debt	$2,295	$ 2,263
Less: current portion	(9)	(8)
Noncurrent long-term debt	$2,286	$ 2,255
PROJECT DEBT:		
North America project debt:		
1.75% - 6.45% project debt related to service fee structures due 2017 through 2035	$108	$ 117
5.00% Union capital lease due 2016 through 2053	101	—
5.248% - 6.20% project debt related to tip fee structures due 2016 through 2020	16	23
Unamortized debt premium, net	4	5
Less: deferred financing costs related to North America project debt	(1)	(1)
Total North America project debt	$228	$ 144
Other project debt:		
Dublin senior loan due 2021 (5.72% - 6.41%)(2)	$142	$ —
Debt discount related to Dublin senior loan	(7)	(8)
Less: deferred financing cost related to Dublin senior loan	(19)	(15)
Dublin senior loan, net	$116	$ (23)
Dublin junior loan due 2022 (9.23% - 9.73%)	$61	$ 57
Debt discount related to Dublin junior loan	—	(1)
Less: deferred financing costs related to Dublin junior loan	(1)	(2)
Dublin junior loan, net	$60	$ 54
Total other project debt, net	$176	$ 31
Total project debt	$404	$ 175
Less: Current portion, includes $1 of net unamortized premium	(23)	(16)
Noncurrent project debt	$381	$ 159
TOTAL CONSOLIDATED DEBT	$2,699	$ 2,438
Less: Current debt	(32)	(24)
TOTAL NONCURRENT CONSOLIDATED DEBT	$2,667	$ 2,414

(1) Eurodollar rates only; excludes base rate borrowings.
(2) Reflects hedged fixed rates.

COVANTA HOLDING CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED FINANCIAL STATEMENTS (UNAUDITED) - (Continued)

Credit Facilities

Our subsidiary, Covanta Energy, has $1.2 billion in senior secured credit facilities consisting of a $1.0 billion revolving credit facility, expiring 2019 through 2020, (the "Revolving Credit Facility") and a $200 million term loan due 2020 (the "Term Loan") (collectively referred to as the "Credit Facilities").

Availability under Revolving Credit Facility

As of September 30, 2016, we had availability under the Revolving Credit Facility as follows (in millions):

	Total Available Under Credit Facility	Expiring (1)	Direct Borrowings as of September 30, 2016	Outstanding Letters of Credit as of September 30, 2016	Availability as of September 30, 2016
Revolving Credit Facility	$ 1,000	2020	$ 384	$ 148	$ 468

(1) The Revolving Credit Facility consists of two tranches; Tranche A ($950 million), which expires in 2020, and Tranche B ($50 million), which expires in March 2019.

Repayment Terms

As of September 30, 2016, the Term Loan has mandatory remaining amortization payments of $1 million in 2016, $5 million in each of the years 2017 through 2019 and $182 million in 2020. The Credit Facilities are pre-payable at par at our option at any time.

Guarantees and Security

The Credit Facilities are guaranteed by us and by certain of our subsidiaries. The subsidiaries that are party to the Credit Facilities agreed to secure all of the obligations under the Credit Facilities by granting, for the benefit of secured parties, a first priority lien on substantially all of their assets, to the extent permitted by existing contractual obligations; a pledge of substantially all of the capital stock of each of our domestic subsidiaries and 65% of substantially all the capital stock of each of our foreign subsidiaries which are directly owned, in each case to the extent not otherwise pledged.

Credit Agreement Covenants

The loan documentation governing the Credit Facilities contains various affirmative and negative covenants, as well as financial maintenance covenants (financial ratios), that limit our ability to engage in certain types of transactions. We were in compliance with all of the affirmative and negative covenants under the Credit Facilities as of September 30, 2016.

Union County EfW Capital Lease Arrangement

In June 2016, we extended the lease term related to the Union County EfW facility through 2053, which resulted in capital lease treatment for the revised lease. We recorded lease liability of $104 million, calculated utilizing an incremental borrowing rate of 5.0%. The lease includes certain periods of contingent rentals based upon plant performance as either a share of revenue or a share of plant profits. These contingent payments have been excluded from the calculation of the lease liability and instead will be treated as a period expense when incurred. As of September 30, 2016, the outstanding borrowings under the capital lease have mandatory amortization payments remaining as follows (in millions):

	Remainder of 2016	2017	2018	2019	2020	Thereafter
Annual Remaining Amortization	$ 2	$ 5	$ 5	$ 5	$ 6	$ 78

Other Non-current Liabilities

As of September 30, 2016, the Dublin convertible preferred instrument of $91 million was included in other noncurrent liabilities in our condensed consolidated balance sheet.

Capitalized Interest

Interest expense paid and costs amortized to interest expense related to project financing are capitalized during the construction and start-up phase of the project. Total interest expense capitalized was $7 million and $2 million during the three months ended September 30, 2016 and 2015, respectively, and $20 million and $4 million during the nine months ended September 30, 2016 and 2015, respectively.

NOTE 7. INCOME TAXES

We record our interim tax provision based upon our estimated annual effective tax rate ("ETR") and account for tax effects of discrete events in the period in which they occur. We review the ETR on a quarterly basis as projections are revised and laws are enacted. The ETRs were (50)% and 48% for the nine months ended September 30, 2016 and September 30, 2015, respectively. The decrease in the ETR was primarily attributable to the gain from the sale of ownership interests in China, which was tax effected discretely as it was deemed unusual and infrequent. In addition, the changes in the mix of earnings and the change from forecasted pre-tax income in 2015 to forecasted pre-tax loss in 2016 also contributed to the ETR change.

NOTE 8. SUPPLEMENTARY INFORMATION

Pass through costs

Pass through costs are costs for which we receive a direct contractually committed reimbursement from the municipal client which sponsors an energy-from-waste project. These costs generally include utility charges, insurance premiums, ash residue transportation and disposal, and certain chemical costs. These costs are recorded net of municipal client reimbursements in our condensed consolidated financial statements. Total pass through costs were $9 million and $13 million for the three months ended September 30, 2016 and 2015, respectively, and $28 million and $34 million for the nine months ended September 30, 2016 and 2015, respectively.

Impairment charges

During the nine months ended September 30, 2016, we recorded non-cash impairment charges of $19 million, pre-tax, of which $13 million, related to the previously planned closure of our Pittsfield EfW facility and $3 million, pre-tax, related to our Tartech investment. See Note 3. Dispositions and Other for additional information.

During the nine months ended September 30, 2015, we identified indicators of impairment associated with our biomass facilities, primarily due to a decline in energy market pricing. As a result of these developments, we recorded a non-cash impairment charge of $24 million, pre-tax, which was calculated based on a range of potential outcomes utilizing various estimated cash flows for these facilities utilizing Level 3 inputs.

NOTE 9. STOCK-BASED COMPENSATION

During the nine months ended September 30, 2016, we awarded certain employees grants of 748,569 shares of restricted stock and 437,275 restricted stock units ("RSUs"). The restricted stock awards will be expensed over the requisite service period, subject to an assumed 12% average forfeiture rate. The terms of the restricted stock awards include vesting provisions based solely on continued service. If the service criteria are satisfied, the restricted stock awards generally vest during March of 2017, 2018, and 2019.

Additionally, during the nine months ended September 30, 2016, we awarded certain employees grants of 390,728 RSUs that will vest based upon the Company’s cumulative Free Cash Flow per share over a three year performance period.

During the nine months ended September 30, 2016, we withheld 210,169 shares of our common stock in connection with tax withholdings for vested stock awards.

On May 5, 2016, we awarded 9,000 shares of restricted stock and 54,591 restricted stock units for annual director compensation. We determined the service vesting condition of these restricted stock awards and restricted stock units to be non-substantive and, in accordance with accounting principles for stock compensation, recorded the entire fair value of the awards as compensation expense on the grant date.

On September 22, 2016, the Board of Directors appointed two new board members. We awarded 5,550 restricted stock units for the prorated portion of their annual director compensation. We determined the service vesting condition of these restricted stock awards and restricted stock units to be non-substantive and, in accordance with accounting principles for stock compensation, recorded the entire fair value of the awards as compensation expense on the grant date.

Compensation expense related to our stock-based awards totaled $4 million and $4 million for the three months ended September 30, 2016 and 2015, respectively and $13 million and $15 million for the nine months ended September 30, 2016 and 2015, respectively. The stock-based award compensation for the nine months ended September 30, 2015 included expense recognized for stock awards and accelerated vesting of stock awards pursuant to separation agreements in connection with the departure of two executive offers during the nine months ended September 30, 2015.

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Unrecognized stock-based compensation expense and weighted-average years to be recognized are as follows (in millions, except for weighted average years):

	As of September 30, 2016	
	Unrecognized stock-based compensation	Weighted-average years to be recognized
Restricted stock awards	$ 9	1.5
Restricted stock units	$ 9	2.3

NOTE 10. FINANCIAL INSTRUMENTS

Fair Value Measurements

Authoritative guidance associated with fair value measurements provides a framework for measuring fair value and establishes a fair value hierarchy that prioritizes the inputs used to measure fair value, giving the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 inputs), then significant other observable inputs (Level 2 inputs) and the lowest priority to significant unobservable inputs (Level 3 inputs).The following methods and assumptions were used to estimate the fair value of each class of financial instruments:

- For cash and cash equivalents, restricted funds, and marketable securities, the carrying value of these amounts is a reasonable estimate of their fair value. The fair value of restricted funds held in trust is based on quoted market prices of the investments held by the trustee.
- Fair values for long-term debt and project debt are determined using quoted market prices.
- The fair value for interest rate swaps were determined by obtaining quotes from two counterparties (one is a holder of the long position and the other is in the short) and extrapolating those across the long and short notional amounts. The fair value of the interest rate swaps was adjusted to reflect counterparty risk of non-performance, and was based on the counterparty's credit spread in the credit derivatives market.
- The fair values of our energy hedges were determined using the spread between our fixed price and the forward curve information available within the market.
- The fair value of our foreign currency hedge was determined by obtaining quotes from two counterparties and is based on market accepted option pricing methodology which utilizes inputs such as the currency spot rate as of the balance sheet date, the strike price of the options and volatility.

The estimated fair value amounts have been determined using available market information and appropriate valuation methodologies. However, considerable judgment is necessarily required in interpreting market data to develop estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts that we would realize in a current market exchange. The fair-value estimates presented herein are based on pertinent information available to us as of September 30, 2016. Such amounts have not been comprehensively revalued for purposes of these financial statements since September 30, 2016, and current estimates of fair value may differ significantly from the amounts presented herein.

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COVANTA HOLDING CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED FINANCIAL STATEMENTS (UNAUDITED) - (Continued)

The following table presents information about the fair value measurement of our assets and liabilities as of September 30, 2016 and December 31, 2015:

Financial Instruments Recorded at Fair Value on a Recurring Basis:	Fair Value Measurement Level	As of September 30, 2016	December 31, 2015
		(In millions)	
Assets:			
Cash and cash equivalents:			
Bank deposits and certificates of deposit	1	$ 109	$ 89
Money market funds	1	4	5
Total cash and cash equivalents:		113	94
Restricted funds held in trust:			
Bank deposits and certificates of deposit	1	18	9
Money market funds	1	38	66
U.S. Treasury/Agency obligations (1)	1	15	18
State and municipal obligations	1	46	59
Commercial paper/Guaranteed investment contracts/Repurchase agreements	1	2	8
Total restricted funds held in trust:		119	160
Investments:			
Mutual and bond funds (2)	1	2	2
Derivative asset — Energy hedges	2	11	21
Total assets:		$ 245	$ 277
Liabilities:			
Derivative liability — Interest rate swaps	2	$ 27	$ 14
Total liabilities:		$ 27	$ 14

The following financial instruments are recorded at their carrying amount (in millions):

Financial Instruments Recorded at Carrying Amount:	As of September 30, 2016		As of December 31, 2015	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Assets:				
Accounts receivable (3)	$ 300	$ 300	$ 314	$ 314
Liabilities:				
Long-term debt	$ 2,295	$ 2,341		