

COVANTA HOLDING CORP

Form 10-Q

April 20, 2011

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**Form 10-Q**

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the quarterly period ended March 31, 2011**

**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**

*(State or Other Jurisdiction of  
Incorporation or Organization)*

**445 South Street, Morristown, NJ**

*(Address of Principal Executive Office)*

**95-6021257**

*(I.R.S. Employer  
Identification Number)*

**07960**

*(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  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  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

**Applicable Only to Corporate Issuers:**

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

<b>Class</b>	<b>Outstanding at April 14, 2011</b>
Common Stock, \$0.10 par value	147,094,386 shares

**COVANTA HOLDING CORPORATION AND SUBSIDIARIES**  
**FORM 10-Q QUARTERLY REPORT**  
**For the Quarter Ended March 31, 2011**

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**CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS**

Certain statements in this Quarterly Report on Form 10-Q may constitute forward-looking statements as defined in Section 27A of the Securities Act of 1933 (the Securities Act ), Section 21E of the Securities Exchange Act of 1934 (the Exchange Act ), the Private Securities Litigation Reform Act of 1995 (the PSLRA ) or in releases made by the Securities and Exchange Commission ( SEC ), all as may be amended from time to time. Such forward-looking statements involve known and unknown risks, uncertainties and other important factors that could cause the actual results, performance or achievements of Covanta Holding Corporation and its subsidiaries ( Covanta ) or industry results, to differ materially from any future results, performance or achievements expressed or implied by such forward-looking statements. Statements that are not historical fact are forward-looking statements. Forward-looking statements can be identified by, among other things, the use of forward-looking language, such as the words plan, believe, expect, anticipate, intend, estimate, project, may, will, would, could, should, seeks, similar words, or the negative of these terms or other variations of these terms or comparable language, or by discussion of strategy or intentions. These cautionary statements are being made pursuant to the Securities Act, the Exchange Act and the PSLRA with the intention of obtaining the benefits of the safe harbor provisions of such laws. Covanta cautions investors that any forward-looking statements made by Covanta are not guarantees or indicative of future performance. Important assumptions and other important factors that could cause actual results to differ materially from those forward-looking statements with respect to Covanta include, but are not limited to, the risks and uncertainties affecting their businesses described in Item 1A. Risk Factors of Covanta s Annual Report on Form 10-K for the year ended December 31, 2010 and in other filings by Covanta with the SEC.

Although Covanta believes that its plans, intentions and expectations reflected in or suggested by such forward-looking statements are reasonable, actual results could differ materially from a projection or assumption in any of its forward-looking statements. Covanta s future financial condition and results of operations, as well as any forward-looking statements, are subject to change and inherent risks and uncertainties. The forward-looking statements contained in this Quarterly Report on Form 10-Q are made only as of the date hereof and Covanta does not have or undertake any obligation to update or revise any forward-looking statements whether as a result of new information, subsequent events or otherwise, unless otherwise required by law.

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

	<b>For the Three Months Ended March 31,</b>	
	<b>2011</b>	<b>2010</b>
	<b>(Unaudited)</b>	
	<b>(In thousands, except per share amounts)</b>	
<b>OPERATING REVENUES:</b>		
Waste and service revenues	\$ 251,096	\$ 241,221
Electricity and steam sales	94,332	100,923
Other operating revenues	31,342	25,549
Total operating revenues	376,770	367,693
<b>OPERATING EXPENSES:</b>		
Plant operating expenses	271,248	263,636
Other operating expenses	27,333	23,528
General and administrative expenses	24,503	26,190
Depreciation and amortization expense	47,365	48,438
Net interest expense on project debt	7,963	10,282
Total operating expenses	378,412	372,074
Operating loss	(1,642)	(4,381)
<b>Other income (expense):</b>		
Investment income	261	223
Interest expense	(16,761)	(10,586)
Non-cash convertible debt related expense	(5,160)	(8,247)
Loss on extinguishment of debt	(356)	
Total other expenses	(22,016)	(18,610)
Loss from continuing operations before income tax benefit and equity in net income (loss) from unconsolidated investments	(23,658)	(22,991)
Income tax benefit	9,986	9,882
Equity in net income (loss) from unconsolidated investments	123	(1,342)
Loss from continuing operations	(13,549)	(14,451)

Income from discontinued operations (including net gain on disposal of assets held for sale of \$135,601 in 2011), net of income tax expense of \$2,193 and \$2,007, respectively	148,942	9,718
<b>NET INCOME (LOSS)</b>	<b>135,393</b>	<b>(4,733)</b>
Less: Net income from continuing operations attributable to noncontrolling interests in subsidiaries	(92)	(1,562)
Less: Net income from discontinued operations attributable to noncontrolling interests in subsidiaries	(1,808)	(938)
Net income attributable to noncontrolling interests in subsidiaries	(1,900)	(2,500)
<b>NET INCOME (LOSS) ATTRIBUTABLE TO COVANTA HOLDING CORPORATION</b>	<b>\$ 133,493</b>	<b>\$ (7,233)</b>
<b>Amounts Attributable to Covanta Holding Corporation stockholders :</b>		
Continuing operations	\$ (13,641)	\$ (16,013)
Discontinued operations	147,134	8,780
Net Income (Loss) Attributable to Covanta Holding Corporation	\$ 133,493	\$ (7,233)
<b>Earnings (Loss) Per Share Attributable to Covanta Holding Corporation stockholders :</b>		
Basic		
Continuing operations	\$ (0.09)	\$ (0.10)
Discontinued operations	1.00	0.05
Covanta Holding Corporation	\$ 0.91	\$ (0.05)
Weighted Average Shares	146,859	153,894
Diluted		
Continuing operations	\$ (0.09)	\$ (0.10)
Discontinued operations	1.00	0.05
Covanta Holding Corporation	\$ 0.91	\$ (0.05)
Weighted Average Shares	146,859	153,894
<b>Cash Dividend Declared Per Share:</b>	<b>\$ 0.075</b>	<b>\$</b>

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



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

	As of	
	March 31, 2011	December 31, 2010
	(Unaudited)	
	(In thousands, except per share amounts)	
<b>ASSETS</b>		
<b>Current:</b>		
Cash and cash equivalents	\$ 326,597	\$ 126,439
Restricted funds held in trust	96,747	125,568
Receivables (less allowances of \$3,898 and \$3,192, respectively)	240,718	271,549
Unbilled service receivables	17,874	23,080
Deferred income taxes	27,363	27,459
Prepaid expenses and other current assets	114,754	110,071
Assets held for sale	88,479	190,957
<b>Total Current Assets</b>	<b>912,532</b>	<b>875,123</b>
Property, plant and equipment, net	2,475,473	2,478,019
Investments in fixed maturities at market (cost: \$28,111 and \$28,537, respectively)	28,669	29,022
Restricted funds held in trust	107,580	107,424
Unbilled service receivables	29,830	31,804
Waste, service and energy contracts, net	463,670	472,190
Other intangible assets, net	77,555	78,892
Goodwill	230,020	230,020
Investments in investees and joint ventures	42,272	45,742
Other assets	323,809	328,066
<b>Total Assets</b>	<b>\$ 4,691,410</b>	<b>\$ 4,676,302</b>
<b>LIABILITIES AND EQUITY</b>		
<b>Current:</b>		
Current portion of long-term debt	\$ 55,489	\$ 6,710
Current portion of project debt	94,059	141,515
Accounts payable	34,469	23,033
Deferred revenue	75,404	71,503
Accrued expenses and other current liabilities	229,557	186,395
Liabilities held for sale	27,381	34,266
<b>Total Current Liabilities</b>	<b>516,359</b>	<b>463,422</b>
Long-term debt	1,497,579	1,557,701
Project debt	636,337	661,788
Deferred income taxes	596,836	604,501
Waste and service contracts	85,531	88,632
Other liabilities	141,456	139,799

<b>Total Liabilities</b>	3,474,098	3,515,843
<b>Commitments and Contingencies (Note 14)</b>		
<b>Equity:</b>		
<b>Covanta Holding Corporation stockholders equity:</b>		
Preferred stock (\$0.10 par value; authorized 10,000 shares; none issued and outstanding)		
Common stock (\$0.10 par value; authorized 250,000 shares; issued 157,541 and 156,847 shares; outstanding 147,134 and 149,891 shares)	15,754	15,685
Additional paid-in capital	877,523	893,373
Accumulated other comprehensive income	12,547	5,233
Accumulated earnings	297,766	214,091
Treasury stock, at par	(1,041)	(696)
<b>Total Covanta Holding Corporation stockholders equity</b>	<b>1,202,549</b>	<b>1,127,686</b>
Noncontrolling interests in subsidiaries	14,763	32,773
<b>Total Equity</b>	<b>1,217,312</b>	<b>1,160,459</b>
<b>Total Liabilities and Equity</b>	<b>\$ 4,691,410</b>	<b>\$ 4,676,302</b>

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

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

	<b>For the Three Months</b>	
	<b>Ended March 31,</b>	
	<b>2011</b>	<b>2010</b>
	<b>(Unaudited)</b>	
	<b>(In thousands)</b>	
<b>OPERATING ACTIVITIES:</b>		
Net income (loss)	\$ 135,393	\$ (4,733)
Less: Income from discontinued operations, net of tax expense	148,942	9,718
Loss from continuing operations	(13,549)	(14,451)
Adjustments to reconcile net loss from continuing operations to net cash provided by operating activities from continuing operations:		
Depreciation and amortization expense	47,365	48,438
Amortization of long-term debt deferred financing costs	1,435	1,682
Amortization of debt premium and discount	(1,301)	(1,851)
Loss on extinguishment of debt	356	
Non-cash convertible debt related expense	5,160	8,247
Stock-based compensation expense	4,569	3,500
Equity in net (income) loss from unconsolidated investments	(123)	1,342
Dividends from unconsolidated investments	4,410	447
Deferred income taxes	(9,452)	(8,541)
Other, net	(1,860)	126
Change in restricted funds held in trust	(14,748)	(12,027)
Change in working capital, net of effects of acquisitions	71,186	88,767
Total adjustments for continuing operations	106,997	130,130
Net cash provided by operating activities from continuing operations	93,448	115,679
Net cash (used in) provided by operating activities from discontinued operations	(10,218)	3,347
Net cash provided by operating activities	83,230	119,026
<b>INVESTING ACTIVITIES:</b>		
Proceeds from the sale of investment securities	4,568	1,228
Purchase of investment securities	(4,138)	(6,411)
Purchase of property, plant and equipment	(38,292)	(37,917)
Acquisition of noncontrolling interests in subsidiaries		(2,000)
Acquisition of businesses, net of cash acquired		(128,254)
Loan issued for the Harrisburg EfW facility to fund certain facility improvements, net of repayments		(400)
Other, net	4,026	(10,439)
Net cash used in investing activities from continuing operations	(33,836)	(184,193)

Net cash provided by (used in) investing activities from discontinued operations	220,248	(65)
Net cash provided by (used in) investing activities	186,412	(184,258)
<b>FINANCING ACTIVITIES:</b>		
Principal payments on long-term debt	(7,578)	(1,857)
Principal payments on project debt	(74,471)	(43,107)
Proceeds from borrowings on project debt	2,169	
Change in restricted funds held in trust	43,659	11,383
Proceeds from the exercise of options for common stock, net		278
Common stock repurchased	(54,371)	
Distributions to partners of noncontrolling interests in subsidiaries	(1,534)	(1,402)
Other, net	(1,834)	2,010
Net cash used in financing activities from continuing operations	(93,960)	(32,695)
Net cash provided by (used in) financing activities from discontinued operations	9,898	(6,085)
Net cash used in financing activities	(84,062)	(38,780)
Effect of exchange rate changes on cash and cash equivalents	1,506	(308)
Net increase (decrease) in cash and cash equivalents	187,086	(104,320)
Cash and cash equivalents at beginning of period	140,646	433,683
Cash and cash equivalents at end of period	327,732	329,363
Less: Cash and cash equivalents of discontinued operations at end of period	1,135	12,814
Cash and cash equivalents of continuing operations at end of period	\$ 326,597	\$ 316,549

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

**Table of Contents****COVANTA HOLDING CORPORATION AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF EQUITY**

	Covanta Holding Corporation Stockholders' Equity						Noncontrolling Interests in Subsidiaries	Total	
	Common Stock Shares	Common Stock Amount	Paid-In Capital	Comprehensive Income	Accumulated Earnings (Unaudited, in thousands)	Treasury Stock Shares			Treasury Stock Amount
Balance as of December 31, 2010	156,847	\$ 15,685	\$ 893,373	\$ 5,233	\$ 214,091	6,956	\$ (696)	\$ 32,773	\$ 1,160,459
Stock-based compensation expense			4,569						4,569
Deferred tax adjustment on stock-based compensation			(1,464)						(1,464)
Cash dividend declared					(10,959)				(10,959)
Common stock purchased			(18,400)		(35,649)	3,228	(322)		(54,371)
Repurchase of equity related to venture under offer			(71)						(71)
Unvested restricted shares forfeited			1			6	(1)		
Shares issued in connection with stock award	694	69	(69)						
Dividends for unvested stock awards			821		(821)				
Shares purchased for tax withholdings									
Forfeited stock awards			(1,237)		(2,389)	217	(22)		(3,648)
Elimination due to sale of controlling interests in								(18,274)	(18,274)

subsidiaries									
distributions to partners of noncontrolling interests in subsidiaries								(1,534)	(1,534)
comprehensive income, net of income taxes:									
net income					133,493			1,900	135,393
foreign currency translation extension and other				7,394				(102)	7,292
postretirement plan unrecognized net loss, net of income tax benefit of \$66				(100)					(100)
net unrealized loss on derivatives, net of income tax benefit of \$53				(81)					(81)
net unrealized gain on securities, net of income tax expense of \$66				101					101
total comprehensive income				7,314	133,493			1,798	142,605
balance as of March 31, 2011	157,541	\$ 15,754	\$ 877,523	\$ 12,547	\$ 297,766	10,407	\$ (1,041)	\$ 14,763	\$ 1,217,312

**Covanta Holding Corporation Stockholders' Equity**

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Other Comprehensive Income (Unaudited, in thousands)	Accumulated Earnings	Treasury Stock Shares	Treasury Stock Amount	Noncontrolling Interests in Subsidiaries	Total
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Balance as of December 31,	155,615	\$ 15,562	\$ 916,423	\$ 7,443	\$ 443,646	679	\$ (68)	\$ 34,163	\$ 1,417,169
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2009									
Stock-based compensation expense			3,500						3,500
Unvested restricted shares forfeited			5			48	(5)		
Exercise of options to purchase common stock	37	3	275						278
Shares issued in non-vested stock award	726	73	(73)						
Acquisition of noncontrolling interests in subsidiaries			(1,284)					(716)	(2,000)
Distributions to partners of noncontrolling interests in subsidiaries								(3,054)	(3,054)
Comprehensive income, net of income taxes:									
Net (loss) income						(7,233)		2,500	(4,733)
Foreign currency translation						(1,391)		965	(426)
Pension and other postretirement plan unrecognized net loss, net of income tax benefit of \$29						(74)			(74)
Net unrealized gain on securities, net of income tax expense of \$70						176			176
Total comprehensive (loss) income						(1,289)	(7,233)	3,465	(5,057)
Balance as of March 31, 2010	156,378	\$ 15,638	\$ 918,846	\$ 6,154	\$ 436,413	727	\$ (73)	\$ 33,858	\$ 1,410,836

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



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

**NOTE 1. ORGANIZATION AND BASIS OF PRESENTATION**

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

**Organization**

We are 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), as well as other waste disposal and renewable energy production businesses. Energy-from-waste serves two key markets as both a sustainable waste disposal 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.

We operate and/or have ownership positions in 44 energy-from-waste facilities, which are primarily located in North America, and 18 additional energy generation facilities, including other renewable energy production facilities in North America (wood biomass, landfill gas and hydroelectric) and independent power production (IPP) facilities in Asia. We hold equity interests in energy-from-waste facilities in China and Italy. We also operate waste management infrastructure that is complementary to our core EfW business.

We have one reportable segment which is Americas and is comprised of waste and energy services operations primarily in the United States and Canada. For additional information, see Note 6. Financial Information by Business Segments.

In 2010, we adopted a plan to sell our interests in our fossil fuel independent power production facilities in the Philippines, India, and Bangladesh. During the first quarter of 2011, we completed the sale of our interests in a 510 megawatt (MW) (gross) coal-fired electric power generation facility in the Philippines (Quezon) and we completed the sale of our majority equity interests in a 106 MW (gross) heavy fuel-oil fired electric power generation facilities in Tamil Nadu, India (Samalpatti). In April 2011, we signed an agreement to sell our majority equity interests in our 106 MW (gross) heavy fuel-oil fired electric power generation facility also in Tamil Nadu, India (Madurai). The remaining asset held for sale is our equity interest in a barge-mounted 126 MW (gross) diesel/natural gas-fired electric power generation facility located near Haripur, Bangladesh. See Note 4. Assets Held for Sale and Dispositions and Note 15. Subsequent Event for additional information.

**Basis of Presentation**

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles (GAAP) and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (including normal recurring accruals) considered necessary for fair presentation have been included in our financial statements. 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 ended December 31, 2011. 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, 2010 (Form 10-K).

We use the equity method to account for our investments for which we have the ability to exercise significant influence over the operating and financial policies of the investee. Consolidated net income includes our proportionate share of the net income or loss of these companies. Such amounts are classified as equity in net income from unconsolidated investments in our condensed consolidated financial statements. Investments in companies in which we do not have the ability to exercise significant influence are carried at the lower of cost or estimated realizable value. We monitor investments for other-than-temporary declines in value and make reductions when appropriate.

**Reclassifications**

As more fully described in Note 4. Assets Held for Sale and Dispositions, during the fourth quarter of 2010, the operations of our fossil fuel independent power production facilities held for sale met the criteria to be classified as

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

discontinued operations. The assets and liabilities associated with these businesses are presented in our condensed consolidated balance sheets as Current Assets Held for Sale and Current Liabilities Held for Sale. The results of operations of these businesses are included in the condensed consolidated statements of operations as Income from discontinued operations, net of tax. The cash flows of these businesses are also presented separately in our condensed consolidated statements of cash flows. All corresponding prior year periods presented in our condensed consolidated financial statements and accompanying notes have been reclassified to reflect the discontinued operations presentation.

During the first quarter of 2011, we corrected our presentation of the condensed consolidated balance sheet at December 31, 2010 to adjust a portion of the excess of purchase price over par value for treasury stock transactions from additional paid-in capital to retained earnings. We have adjusted approximately \$66 million to retained earnings from additional paid-in capital as of December 31, 2010. This change had no impact on total equity.

**NOTE 2. RECENT ACCOUNTING PRONOUNCEMENTS**

In April 2011, the Financial Accounting Standards Board issued an accounting standard related to disclosures about the classification of certain loan modifications as troubled debt restructurings. The standard provides additional clarification in determining whether a creditor has granted a concession and whether a debtor is experiencing financial difficulties for purposes of determining whether a restructuring constitutes a troubled debt restructuring. We are required to adopt this standard effective June 15, 2011, although earlier application is permitted. This standard must be applied retrospectively to restructurings occurring on or after the beginning of the year. We do not expect this accounting standard to have an impact on our condensed consolidated financial statements.

**NOTE 3. ACQUISITIONS AND BUSINESS DEVELOPMENT**

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

**Acquisitions and Business Development**

**Fairfax County Energy-from-Waste Facility**

In August 2010, the service fee contract with Fairfax County was extended from 2011 to 2016 pursuant to a unilateral option held by the County. The terms of the contract remain unchanged under the extension; however, the project debt on the facility was repaid in February 2011, and since Fairfax County had previously paid debt service as a component of the service fee during the term of the original contract, the County will effectively retain the benefit of the debt repayment during the 5 year extension period. In March 2011, the county announced its desire to proceed to negotiate a long-term extension to the contract rather than exercise a fair market value purchase option it holds under the existing agreement. The parties are currently working to complete the contract extension.

**Huntington Energy-from-Waste Facility**

In March 2010, we acquired a nominal limited partnership interest held by a third party in Covanta Huntington Limited Partnership, our subsidiary which owns and operates an energy-from-waste facility in Huntington, New York, for cash consideration of \$2.0 million.

*Dade Energy-from-Waste Business*

In February 2010, we completed a transaction with Veolia Environmental Services North America Corp. in which we paid cash consideration of \$128.3 million for an energy-from-waste business located in Florida. The operation acquired included a long-term operating contract with the respective municipal client.

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

**NOTE 4. ASSETS HELD FOR SALE AND DISPOSITIONS**

In 2010, we adopted a plan to sell our interests in our fossil fuel independent power production facilities in the Philippines, India, and Bangladesh.

During the first quarter of 2011, we completed the sale of our majority equity interests in a 106 MW (gross) heavy fuel-oil fired electric power generation facilities in Tamil Nadu, India ( Samalpatti ) and we completed the sale of our interests in a 510 MW (gross) coal-fired electric power generation facility in the Philippines ( Quezon ). The Quezon assets sold consisted of our entire interest in Covanta Philippines Operating, Inc., which provided operation and maintenance services to the facility, as well as our 26% ownership interest in the project company, Quezon Power, Inc. We received a combined total of cash proceeds of approximately \$225 million, net of transaction costs.

In April 2011, we signed an agreement with Samayanallur Power Investments Private Limited ( SPI ) to sell our interests in the 106 MW (gross) heavy fuel-oil fired electric power generation facility in Tamil Nadu, India ( Madurai ). See Note 15. Subsequent Event for additional information. The remaining asset held for sale is our equity interest in a barge-mounted 126 MW (gross) diesel/natural gas-fired electric power generation facility located near Haripur, Bangladesh.

The assets and liabilities associated with these businesses are presented in our condensed consolidated balance sheets as Current Assets Held for Sale and Current Liabilities Held for Sale . The results of operations of these businesses are included in the condensed consolidated statements of operations as Income from discontinued operations, net of tax. The cash flows of these businesses are also presented separately in our condensed consolidated statements of cash flows. All corresponding prior year periods presented in our condensed consolidated financial statements and accompanying notes have been reclassified to reflect the discontinued operations presentation.

The following table summarizes the operating results of the discontinued operations for the periods indicated (in thousands):

	<b>For the Three Months Ended March 31,</b>	
	<b>2011</b>	<b>2010</b>
Revenues	\$ 46,170	\$ 49,102
Operating expenses, including net gain on disposal of assets held for sale and loss on assets held for sale <sup>(A)</sup>	\$ 99,043	\$ (42,750)
Income before income tax expense and equity in net income from unconsolidated investments	\$ 145,604	\$ 6,713
Equity in net income from unconsolidated investments	\$ 5,530	\$ 5,012
Income from discontinued operations, net of income tax expense of \$2,193 and \$2,007, respectively	\$ 148,942	\$ 9,718

(A) During the first quarter of 2011, we recorded a net after-tax gain on disposal of assets held for sale of \$135.6 million. We recorded a loss on assets held for sale of \$7.8 million in 2010.



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

The following table sets forth the assets and liabilities of the asset held for sale included in the condensed consolidated balance sheets as of the dates indicated (in thousands):

	<b>March 31, 2011</b>	<b>As of December 31, 2010</b>
Cash and cash equivalents	\$ 1,135	\$ 14,207
Restricted funds held in trust	16,675	18,966
Accounts receivable	21,019	19,479
Prepaid expenses and other assets	18,293	26,326
Property, plant and equipment	9,481	30,206
Investments in investees and joint ventures	21,819	81,322
Other long-term assets	57	451
 Assets held for sale	 \$ 88,479	 \$ 190,957
 Accounts payable	 \$ 11,589	 \$ 2,976
Accrued expenses and other	1,477	11,547
Project debt	9,224	15,555
Other noncurrent liabilities	5,091	4,188
 Liabilities held for sale	 \$ 27,381	 \$ 34,266

**NOTE 5. EARNINGS PER SHARE**

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

	<b>For the Three Months Ended March 31, 2011</b>	
	<b>2011</b>	<b>2010</b>
Net loss from continuing operations	\$ (13,641)	\$ (16,013)
Net income from discontinued operations	147,134	8,780
 Net income (loss) attributable to Covanta Holding Corporation	 \$ 133,493	 \$ (7,233)

**Basic earnings (loss) per share:**

Weighted average basic common shares outstanding	146,859	153,894
Continuing operations	\$ (0.09)	\$ (0.10)
Discontinued operations	1.00	0.05
Covanta Holding Corporation	\$ 0.91	\$ (0.05)



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

	<b>For the Three Months Ended March 31,</b>	
	<b>2011</b>	<b>2010</b>
<b>Diluted earnings (loss) per share:</b>		
Weighted average basic common shares outstanding	146,859	153,894
Dilutive effect of stock options		
Dilutive effect of restricted stock		
Dilutive effect of convertible debentures		
Dilutive effect of warrants		
Weighted average diluted common shares outstanding	146,859	153,894
Continuing operations	\$ (0.09)	\$ (0.10)
Discontinued operations	1.00	0.05
Covanta Holding Corporation	\$ 0.91	\$ (0.05)
Securities excluded from the weighted average dilutive common shares outstanding because their inclusion would have been antidilutive:		
Stock options	2,141	2,583
Restricted stock	1,469	1,327
Restricted stock units	968	986
Warrants	27,226	24,803

In 2007, we issued 1.00% Senior Convertible Debentures due 2027 (the "Debentures"). The Debentures are convertible under certain circumstances if the closing sale price of our common stock exceeds a specified conversion price before February 1, 2025. The conversion rate for the Debentures is 38.9883 shares of our common stock per \$1,000 principal amount of Debentures, which is equivalent to a conversion price of \$25.65 per share. As of March 31, 2011, the Debentures did not have a dilutive effect on earnings per share because the average market price during the periods presented was below the strike price.

In 2009, we entered into privately negotiated warrant transactions in connection with the issuance of 3.25% Cash Convertible Senior Notes due 2014 (the "3.25% Notes"). These warrants could have a dilutive effect to the extent that the price of our common stock exceeds the applicable strike price of \$23.45. As of March 31, 2011, the warrants did not have a dilutive effect on earnings per share because the average market price during the periods presented was below the strike price.

**NOTE 6. FINANCIAL INFORMATION BY BUSINESS SEGMENTS**

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

	Americas	All Other (1)	Total
<b>Three Months Ended March 31, 2011:</b>			
Operating revenues	\$ 366,561	\$ 10,209	\$ 376,770
Depreciation and amortization expense	46,907	458	47,365
Operating income (loss)	6,532	(8,174)	(1,642)
<b>Three Months Ended March 31, 2010:</b>			
Operating revenues	\$ 357,287	\$ 10,406	\$ 367,693
Depreciation and amortization expense	48,021	417	48,438
Operating income (loss)	1,727	(6,108)	(4,381)

(1) All other is comprised of the financial results of our insurance subsidiaries operations and our remaining international assets that are not classified as assets held for sale. See Note 4. Assets Held for Sale and Dispositions.

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

**NOTE 7. CHANGES IN CAPITALIZATION****Long-Term Debt**

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

	<b>March 31, 2011</b>	<b>As of December 31, 2010</b>
7.25% Senior Notes due 2020	\$ 400,000	\$ 400,000
3.25% Cash Convertible Senior Notes due 2014	460,000	460,000
Debt discount related to Cash Convertible Senior Notes	(85,552)	(91,212)
Cash conversion option derivative at fair value	105,482	115,994
3.25% Cash Convertible Senior Notes, net	479,930	484,782
1.00% Senior Convertible Debentures due 2027	51,362	57,289
Debt discount related to Convertible Debentures	(2,588)	(3,720)
1.00% Senior Convertible Debentures, net	48,774	53,569
Term Loan Facility due 2014	624,000	625,625
Other long-term debt	364	435
Total	1,553,068	1,564,411
Less: current portion	(55,489)	(6,710)
Total long-term debt	\$ 1,497,579	\$ 1,557,701

**Credit Facilities**

We have credit facilities which are comprised of a \$300 million revolving credit facility (the Revolving Credit Facility), a \$320 million funded letter of credit facility (the Funded L/C Facility), and a \$650 million term loan (the Term Loan Facility) (collectively referred to as the Credit Facilities). As of March 31, 2011, we had available credit for liquidity as follows (in thousands):

<b>Total Available Under Facility</b>	<b>Maturing</b>	<b>Outstanding Letters of Credit as of March 31, 2011</b>	<b>Available as of March 31, 2011</b>
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Revolving Credit Facility (1)	\$ 300,000	2013	\$	\$ 300,000
Funded L/C Facility	\$ 320,000	2014	\$ 286,239	\$ 33,761

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

***7.25% Senior Notes due 2020 (the 7.25% Notes )***

For specific criteria related to redemption features of the 7.25% Notes, refer to Note 12 of the Notes to Consolidated Financial Statements in our Form 10-K.

***3.25% Cash Convertible Senior Notes due 2014 (the 3.25% Notes )***

Under limited circumstances, the 3.25% Notes are convertible by the holders thereof into cash only, based on a conversion rate of 59.1871 shares of our common stock per \$1,000 principal amount of 3.25% Notes (which represents a conversion price of approximately \$16.90 per share) subject to certain customary adjustments as provided in the indenture for the 3.25% Notes. We will not deliver common stock (or any other securities) upon conversion under any circumstances.

For specific criteria related to contingent interest, conversion or redemption features of the 3.25% Notes and details related to the cash conversion option, cash convertible note hedge and warrants related to the 3.25% Notes, refer to Note 12 of the Notes to Consolidated Financial Statements in our Form 10-K.

For details related to the fair value for the contingent interest feature, cash conversion option, and cash convertible note hedge related to the 3.25% Notes, see Note 13. Derivative Instruments.

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

**1.00% Senior Convertible Debentures due 2027 (the Debentures )**

In November 2010, we commenced a tender offer to purchase for cash any and all of our outstanding 1.00% Senior Convertible Debentures due 2027. We offered to purchase the Debentures at a purchase price of \$990 for each \$1,000 principal amount of Debentures. During the three months ended March 31, 2011, an additional \$5.9 million of the Debentures were purchased. As of March 31, 2011, there were \$51.4 million aggregate principal amount of the Debentures outstanding. We may purchase Debentures that remained outstanding following termination or expiration of the tender offer in the open market, in privately negotiated transactions, through tender offers, exchange offers, by redemption or otherwise.

Under limited circumstances, prior to February 1, 2025, the Debentures are convertible by the holders into cash and shares of our common stock, if any, based on a conversion rate of 38.9883 shares of our common stock per \$1,000 principal amount of Debentures, (which represents a conversion price of approximately \$25.65 per share) or 2,002,517 issuable shares. As of March 31, 2011, if the Debentures were converted, no shares would have been issued since the trading price of our common stock was below the conversion price of the Debentures.

For specific criteria related to contingent interest, conversion or redemption features of the Debentures, refer to Note 12 of the Notes to Consolidated Financial Statements in our Form 10-K.

For details related to the fair value for the contingent interest feature related to the Debentures, see Note 13. Derivative Instruments.

**Debt Discount for the 3.25% Notes and the Debentures**

The debt discount related to the 3.25% Notes and the Debentures is accreted over their respective terms and recognized as non-cash convertible debt related expense. The following table details the amount of the accretion of debt discount as of March 31, 2011 included or expected to be included in our condensed consolidated financial statements for each of the periods indicated (in millions):

	<b>2011</b>	<b>For the Years Ended</b>		
		<b>2012</b>	<b>2013</b>	<b>2014</b>
3.25% Cash Convertible Senior Notes due 2014	\$ 17.9	\$ 26.0	\$ 28.8	\$ 12.9
1.00% Senior Convertible Debentures due 2027 (1)	\$ 2.3	\$ 0.3	\$	\$

- (1) At our option, the Debentures are subject to redemption at any time on or after February 1, 2012, in whole or in part, at a redemption price equal to 100% of the principal amount of the Debentures being redeemed, plus accrued and unpaid interest. In addition, holders may require us to repurchase their Debentures on February 1, 2012, February 1, 2017, and February 1, 2022, in whole or in part, for cash at a repurchase price equal to 100% of the principal amount of the Debentures being repurchased, plus accrued and unpaid interest. For purposes of this chart, we have assumed that the Debentures will be repurchased pursuant to the holders' option on February 1, 2012.

**Loss on Extinguishment of Debt**

During the first quarter of 2011, we recorded a loss on extinguishment of debt of \$0.4 million, pre-tax, related to the additional \$5.9 million of the outstanding Debentures purchased under the tender offer. The loss on extinguishment of debt was comprised of the difference between the fair value and carrying value of the liability component of the Debentures tendered.

### **Equity**

During the three months ended March 31, 2011, we granted 694,762 restricted stock awards. For information related to stock-based award plans, see Note 11. Stock-Based Compensation.

During the three months ended March 31, 2011, we repurchased 216,605 shares of our common stock in connection with tax withholdings for vested stock awards.

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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

On March 14, 2011, the Board of Directors approved a regular cash dividend of \$0.075 per share. The dividend was paid on April 12, 2011 to stockholders of record as of the close of business on March 30, 2011. In addition, pursuant to our Equity Plan, holders of unvested restricted stock awards received a dividend in the form of additional restricted stock awards with the same vesting conditions as the underlying shares of restricted stock to which they relate.

On March 14, 2011, the Board of Directors approved an additional \$50 million of share repurchase authorization, bringing the total authorized amount to \$200 million. Under the program, common stock repurchases may be made in the open market, in privately negotiated transactions from time to time, or by other available methods, at management's discretion in accordance with applicable federal securities laws. The timing and amounts of any repurchases will depend on many factors, including our capital structure, the market price of our common stock and overall market conditions. During the three months ended March 31, 2011, we repurchased 3.2 million shares of our common stock at a weighted average cost of \$16.84 per share for an aggregate amount of approximately \$54.4 million. As of March 31, 2011, the amount remaining under our currently authorized share repurchase program was \$50.4 million.

**NOTE 8. INCOME TAXES**

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

We currently estimate our annual effective tax rate for the year ending December 31, 2011 to be approximately 42.6%. We review the annual effective tax rate on a quarterly basis as projections are revised and laws are enacted. The effective income tax rate was 42.2% and 43.0% for the three months ended March 31, 2011 and 2010, respectively. The liability for uncertain tax positions, exclusive of interest and penalties, was \$130.1 million as of both March 31, 2011 and December 31, 2010. Included in the balance of unrecognized tax benefits as of March 31, 2011 are potential benefits of \$130.1 million that, if recognized, would impact the effective tax rate. Acquisition related reserves and some other reserves in the liability for uncertain tax positions may decrease by approximately \$18.1 million in the next twelve months with respect to the expiration of statutes, and the release of restricted funds relating to Covanta Energy pre-emergence tax matters, all of which may impact the tax provision.

For the three months ended March 31, 2011 and 2010, we recognized expenses of \$0.5 million and a benefit of \$1.7 million, respectively, of interest and penalties on uncertain tax positions. As of March 31, 2011 and December 31, 2010, we had accrued interest and penalties associated with liabilities for unrecognized tax positions of \$7.8 million and \$7.3 million, respectively. We continue to reflect interest accrued on uncertain tax positions and penalties as part of the tax provision.

In the ordinary course of our business, the Internal Revenue Service ( IRS ) and state tax authorities will periodically audit our federal and state tax returns. As issues are examined by the IRS and state auditors, we may decide to adjust the existing liability for uncertain tax positions for issues that were not deemed an exposure at the time we adopted accounting standards related to the accounting for uncertainty in income taxes. Accordingly, we will continue to monitor the results of audits and adjust the liability as needed. Federal income tax returns for Covanta Energy are closed for the years through 2003. However, to the extent net operating loss carryforwards ( NOLs ) are utilized from earlier years, federal income tax returns for Covanta Holding Corporation, formerly known as Danielson Holding Corporation, are still open. State income tax returns are generally subject to examination for a period of three to five

years after the filing of the respective return. The state impact of any federal changes remains subject to examination by various states for a period of up to one year after formal notification to the states. We have various state income tax returns in the process of examination, administrative appeals or litigation.

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



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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

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

We had consolidated federal NOLs estimated to be approximately \$396.9 million for federal income tax purposes as of December 31, 2010, based on the tax returns as filed. The federal NOLs will expire in various amounts from December 31, 2023 through December 31, 2030, if not used. In addition to the consolidated federal NOLs, as of December 31, 2010, we had state NOL carryforwards of approximately \$188.8 million, which expire between 2011 and 2027, capital loss carryforwards of \$0.2 million expiring in 2013, and additional federal credit carryforwards, including production tax credits and minimum tax credits, of \$45.6 million. These deferred tax assets are offset by a valuation allowance of approximately \$19.9 million.

For further information, refer to Note 17. Income Taxes of the Notes to the Consolidated Financial Statements in our Form 10-K.

**NOTE 9. SUPPLEMENTARY INFORMATION****Operating Costs***Pass through costs*

Pass through costs are costs for which we receive a direct contractually committed reimbursement from the municipal client which sponsors an energy-from-waste project. These costs generally include utility charges, insurance premiums, ash residue transportation and disposal and certain chemical costs. These costs are recorded net of municipal client reimbursements in our condensed consolidated financial statements. Total pass through costs were \$23.1 million and \$20.5 million for the three months ended March 31, 2011 and 2010, respectively.

*Other operating expenses*

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

	<b>For the Three Months Ended March 31,</b>	
	<b>2011</b>	<b>2010</b>
Construction costs	\$ 26,105	\$ 20,485
Insurance subsidiary operating expenses <sup>(1)</sup>	3,881	4,070
Foreign exchange loss (gain)	9	(989)
Other	(2,662)	(38)
Total other operating expenses	\$ 27,333	\$ 23,528

(1)

Insurance subsidiary operating expenses are primarily comprised of incurred but not reported loss reserves, loss adjustment expenses and policy acquisition costs.

*Amortization of waste, service and energy contracts*

Our waste, service and energy contracts are intangible assets and liabilities relating to long-term operating contracts at acquired facilities and are recorded upon acquisition at their estimated fair market values based upon discounted cash flows. Intangible assets and liabilities are amortized using the straight line method over their remaining useful lives. The following table details the amount of the actual/estimated amortization expense and contra-expense associated with these

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

intangible assets and liabilities as of March 31, 2011 included or expected to be included in our condensed consolidated statement of income for each of the years indicated (in thousands):

	<b>Waste, Service and Energy Contracts (Amortization Expense)</b>	<b>Waste and Service Contracts (Contra-Expense)</b>
Three Months ended March 31, 2011	\$ 9,938	\$ (3,101)
Remainder of 2011	\$ 27,973	\$ (9,307)
2012	35,770	(12,412)
2013	32,201	(12,390)
2014	29,305	(12,500)
2015	25,952	(8,187)
2016	23,313	(7,906)
Thereafter	289,156	(22,829)
Total	\$ 463,670	\$ (85,531)

**Non-Cash Convertible Debt Related Expense**

The components of non-cash convertible debt related expense are as follows (in thousands):

	<b>Three Months Ended March 31,</b>	
	<b>2011</b>	<b>2010</b>
Debt discount accretion related to the 3.25% Notes	\$ 5,660	\$ 5,116
Debt discount accretion related to the Debentures	775	5,054
Fair value changes related to the cash convertible note hedge	9,237	36,896
Fair value changes related to the cash conversion option derivative	(10,512)	(38,819)
Total non-cash convertible debt related expense	\$ 5,160	\$ 8,247

**NOTE 10. BENEFIT OBLIGATIONS****Pension and Other Benefit Obligations**

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

	<b>Pension Benefits</b>		<b>Other Post-Retirement Benefits</b>	
	<b>For the Three Months Ended March 31,</b>			
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
Interest cost	\$ 1,112	\$ 1,056	\$ 83	\$ 119
Expected return on plan assets	(1,302)	(1,237)		
Amortization of net prior service cost	(82)	(82)		
Amortization of actuarial gain	(7)	(15)	(76)	(25)
Net periodic benefit (credit) cost	\$ (279)	\$ (278)	\$ 7	\$ 94

### **Defined Contribution Plans**

Substantially all of our employees in the United States are eligible to participate in defined contribution plans we sponsor. Our costs related to defined contribution plans were \$3.6 million and \$4.9 million for the three months ended March 31, 2011 and 2010, respectively.

### **NOTE 11. STOCK-BASED COMPENSATION**

During the three months ended March 31, 2011, we awarded certain employees 694,762 restricted stock awards. 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 vest during March of 2012, 2013 and 2014.

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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

On March 14, 2011, the Board of Directors approved a regular cash dividend of \$0.075 per share. The dividend was paid on April 12, 2011 to stockholders of record as of the close of business on March 30, 2011. In addition, pursuant to our Equity Plan, holders of unvested shares of restricted stock received a dividend in the form of additional restricted stock awards with the same vesting conditions as the underlying shares of restricted stock to which they relate.

Compensation expense related to our stock-based awards totaled \$4.6 million and \$3.5 million during the three months ended March 31, 2011 and 2010, respectively.

As of March 31, 2011, we had approximately \$16.4 million, \$4.8 million and \$0.8 million of unrecognized compensation expense related to our unvested restricted stock, unvested restricted stock units, and unvested stock options, respectively. We expect this compensation expense to be recognized over a weighted average period of approximately 1 year for our unvested restricted stock awards, approximately 2 years for our unvested RSUs and approximately 1 year for our unvested stock options.

**NOTE 12. FINANCIAL INSTRUMENTS**

**Fair Value Measurements**

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 of the Note Hedge and the Cash Conversion Option are determined using an option pricing model based on observable inputs such as implied volatility, risk free rate, and other factors. The fair value of the Note Hedge is adjusted to reflect counterparty risk of non-performance, and is based on the counterparty's credit spread in the credit derivatives market. The contingent interest features related to the Debentures and the 3.25% Notes are valued quarterly using the present value of expected cash flow models incorporating the probabilities of the contingent events occurring.

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 March 31, 2011. However, such amounts have not been comprehensively revalued for purposes of these financial statements since March 31, 2011, 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 CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

The following table presents information about the fair value measurement of our assets and liabilities as of March 31, 2011:

Financial Instruments Recorded at Fair Value on a Recurring Basis:	As of March 31, 2011		Fair Value Measurements at Reporting Date Using		
	Carrying Amount	Estimated Fair Value (In thousands)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Assets:</b>					
Cash and cash equivalents:					
Bank deposits and certificates of deposit	\$ 320,989	\$ 320,989	\$ 320,989	\$	\$
Money market funds	5,608	5,608	5,608		
Total cash and cash equivalents:	326,597	326,597	326,597		
Restricted funds held in trust:					
Bank deposits and certificates of deposit	3,630	3,630	3,630		
Money market funds	122,985	122,985	122,985		
U.S. Treasury/Agency obligations (a)	16,137	16,137	16,137		
State and municipal obligations	8,718	8,718	8,718		
Commercial paper/Guaranteed investment contracts/Repurchase agreements	52,857	52,901	52,901		
Total restricted funds held in trust:	204,327	204,371	204,371		
Restricted funds other:					
Bank deposits and certificates of deposit (b)	21,726	21,726	21,726		
Money market funds (c)	14,654	14,654	14,654		
Total restricted funds other:	36,380	36,380	36,380		
Investments:					
Mutual and bond funds (b)	1,972	1,923	1,923		
Investments available for sale:					
U.S. Treasury/Agency obligations (d)	5,797	5,797	5,797		
Residential mortgage-backed securities (d)	5,792	5,792	5,792		
Other government obligations (d)	4,484	4,484	4,484		
Corporate investments (d)	12,596	12,596	12,596		
Equity securities (c)	1,355	1,355	1,355		

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Total investments:		31,996	31,947	31,947		
Derivative Asset	Note Hedge	103,163	103,163		103,163	
Total assets:		\$ 702,463	\$ 702,458	\$ 599,295	\$ 103,163	\$
<b>Liabilities:</b>						
Derivative Liability	Energy Hedges	\$ 571	\$ 571	\$	\$ 571	\$
Derivative Liability	Cash Conversion Option	105,482	105,482		105,482	
Derivative Liabilities	Contingent interest features of the Notes and Debentures	0	0		0	
Total liabilities:		\$ 106,053	\$ 106,053	\$	\$ 106,053	\$

**Financial Instruments Recorded at Carrying Amount:**

**Assets:**

Accounts receivables (e)	\$ 261,128	\$ 261,128
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**Liabilities:**

Long-term debt (excluding Cash Conversion Option)	\$ 1,447,586	\$ 1,519,339
Project debt	\$ 730,396	\$ 747,056

- (a) The U.S. Treasury/Agency obligations in restricted funds held in trust are primarily comprised of Federal Home Loan Mortgage Corporation securities at fair value.
- (b) Included in other noncurrent assets in the condensed consolidated balance sheets.
- (c) Included in prepaid expenses and other current assets in the condensed consolidated balance sheets.
- (d) Included in investments in fixed maturities at market in the condensed consolidated balance sheets.
- (e) Includes \$24.1 million of noncurrent receivables in other noncurrent assets in the condensed consolidated balance sheets.

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

The following table presents information about the fair value measurement of our assets and liabilities as of December 31, 2010:

Financial Instruments Recorded at Fair Value on a Recurring Basis:	As of December 31, 2010		Fair Value Measurements at Reporting Date Using		
	Carrying Amount	Estimated Fair Value (In thousands)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Assets:</b>					
Cash and cash equivalents:					
Bank deposits and certificates of deposit	\$ 48,165	\$ 48,165	\$ 48,165	\$	\$
Money market funds	78,274	78,274	78,274		
Total cash and cash equivalents:	126,439	126,439	126,439		
Restricted funds held in trust:					
Bank deposits and certificates of deposit	3,892	3,885	3,885		
Money market funds	117,183	117,183	117,183		
U.S. Treasury/Agency obligations (a)	56,340	56,335	56,335		
State and municipal obligations	7,144	7,144	7,144		
Commercial paper/Guaranteed investment contracts/Repurchase agreements	48,433	48,698	48,698		
Total restricted funds held in trust:	232,992	233,245	233,245		
Restricted funds other:					
Bank deposits and certificates of deposit (b)	21,721	21,721	21,721		
Money market funds (c)	10,876	10,876	10,876		
U.S. Treasury/Agency obligations (c)	499	499	499		
Residential mortgage-backed securities (c)	1,382	1,382	1,382		
Other government obligations (c)	991	991	991		
Corporate investments (c)	509	509	509		
Total restricted funds other:	35,978	35,978	35,978		
Investments:					
Mutual and bond funds (b)	2,328	2,602	2,602		
Investments available for sale:					
U.S. Treasury/Agency obligations (d)	6,069	6,069	6,069		



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Residential mortgage-backed securities (d)	4,470	4,470	4,470		
Other government obligations (d)	2,375	2,375	2,375		
Corporate investments (d)	16,108	16,108	16,108		
Equity securities (c)	1,284	1,284	1,284		
Total investments:	32,634	32,908	32,908		
Derivative Asset Note Hedge	112,400	112,400		112,400	
Total assets:	\$ 540,443	\$ 540,970	\$ 428,570	\$ 112,400	\$
<b>Liabilities:</b>					
Derivative Liability Energy Hedges	\$ 436	\$ 436	\$	\$ 436	\$
Derivative Liability Cash Conversion Option	115,994	115,994		115,994	
Derivative Liabilities Contingent interest features of the 3.25% Notes and Debentures	0	0		0	
Total liabilities:	\$ 116,430	\$ 116,430	\$	\$ 116,430	\$

**Financial Instruments Recorded at Carrying**

**Amount:**

**Assets:**

Accounts receivables (e)	\$ 292,752	\$ 292,752		
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**Liabilities:**

Long-term debt (excluding Cash Conversion Option)	\$ 1,448,417	\$ 1,497,208		
Project debt	\$ 803,303	\$ 823,310		

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

- (a) The U.S. Treasury/Agency obligations in restricted funds held in trust are primarily comprised of Federal Home Loan Mortgage Corporation securities at fair value.
- (b) Included in other noncurrent assets in the condensed consolidated balance sheets.
- (c) Included in prepaid expenses and other current assets in the condensed consolidated balance sheets.
- (d) Included in investments in fixed maturities at market in the condensed consolidated balance sheets.
- (e) Includes \$24.9 million of noncurrent receivables in other noncurrent assets in the condensed consolidated balance sheets.

**Investments**

Our insurance subsidiaries' fixed maturity debt and equity securities portfolio are classified as available-for-sale and are carried at fair value. Equity securities that are traded on a national securities exchange are stated at the last reported sales price on the day of valuation. Debt securities values are determined by third party matrix pricing based on the last days trading activity. Changes in fair values are credited or charged directly to Accumulated Other Comprehensive Income ( AOCI ) in the condensed consolidated statements of equity as unrealized gains or losses, respectively. Investment gains or losses realized on the sale of securities are determined using the specific identification method. Realized gains and losses are recognized in the condensed consolidated statements of income based on the amortized cost of fixed maturities and the cost basis for equity securities on the date of trade, subject to any previous adjustments for other-than-temporary declines. Other-than-temporary declines in fair value are recorded as realized losses in the condensed consolidated statements of income to the extent they relate to credit losses, and to AOCI to the extent they are related to other factors. The cost basis of the security is also reduced. We consider the following factors in determining whether declines in the fair value of securities are other-than-temporary:

- the significance of the decline in fair value compared to the cost basis;
- the time period during which there has been a significant decline in fair value;
- whether the unrealized loss is credit-driven or a result of changes in market interest rates;
- a fundamental analysis of the business prospects and financial condition of the issuer; and
- our ability and intent to hold the investment for a period of time sufficient to allow for any anticipated recovery in fair value.

Other investments, such as investments in companies in which we do not have the ability to exercise significant influence, are carried at the lower of cost or estimated realizable value.

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

The cost or amortized cost, unrealized gains, unrealized losses and the fair value of our investments categorized by type of security, were as follows (in thousands):

	As of March 31, 2011				As of December 31, 2010			
	Cost or Amortized Cost	Unrealized Gain	Unrealized Loss	Fair Value	Cost or Amortized Cost	Unrealized Gain	Unrealized Loss	Fair Value
<b>Current investments:</b>								
Fixed maturities	\$	\$	\$	\$	\$	\$	\$	\$
Equity securities insurance business	993	373	11	1,355	993	302	11	1,284
<b>Total current investments</b>	<b>\$ 993</b>	<b>\$ 373</b>	<b>\$ 11</b>	<b>\$ 1,355</b>	<b>\$ 993</b>	<b>\$ 302</b>	<b>\$ 11</b>	<b>\$ 1,284</b>
<b>Noncurrent investments:</b>								
Fixed maturities insurance business:								
U.S. government obligations	\$ 306	\$	\$ 6	\$ 300	\$ 307	\$	\$ 4	\$ 303
U.S. government agencies	5,470	51	24	5,497	5,713	72	19	5,766
Residential mortgage-backed securities	5,751	84	43	5,792	4,417	92	39	4,470
Other government obligations	4,444	141	101	4,484	2,331	87	43	2,375
Corporate investments	12,140	472	16	12,596	15,769	454	115	16,108
Total fixed maturities insurance business	28,111	748	190	28,669	28,537	705	220	29,022
Mutual and bond funds	1,972		49	1,923	2,328	274		2,602
<b>Total noncurrent investments</b>	<b>\$ 30,083</b>	<b>\$ 748</b>	<b>\$ 239</b>	<b>\$ 30,592</b>	<b>\$ 30,865</b>	<b>\$ 979</b>	<b>\$ 220</b>	<b>\$ 31,624</b>

The following table sets forth a summary of temporarily impaired investments held by our insurance subsidiary (in thousands):

Description of Investments	As of March 31, 2011		As of December 31, 2010	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	\$ 2,584	\$ 30	\$ 1,215	\$ 23

U.S. Treasury and other direct U.S. Government obligations				
Federal agency mortgage-backed securities	3,665	43	2,070	39
Other government obligations	2,502	101	936	43
Corporate bonds	2,091	16	3,266	115
Total fixed maturities	10,842	190	7,487	220
Equity securities	143	11	167	11
Total temporarily impaired investments	\$ 10,985	\$ 201	\$ 7,654	\$ 231

The number of U.S. Treasury and federal agency obligations, mortgage-backed securities, other government obligations, and corporate bonds temporarily impaired are 6, 6, 6, and 7, respectively. As of March 31, 2011, all of the temporarily impaired fixed maturity investments had maturities greater than 12 months.

Our fixed maturities held by our insurance subsidiary include mortgage-backed securities and collateralized mortgage obligations, collectively ( MBS ) representing 20.2%, and 15.4% of the total fixed maturities as of March 31, 2011 and December 31, 2010, respectively. Our MBS holdings are issued by the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, or the Government National Mortgage Association all of which are rated AAA by Moody's Investors Services. MBS and callable bonds, in contrast to other bonds, are more sensitive to market value declines in a rising interest rate environment than to market value increases in a declining interest rate environment.

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

The expected maturities of fixed maturity securities, by amortized cost and fair value are shown below (in thousands):

	<b>As of March 31, 2011</b>	
	<b>Amortized Cost</b>	<b>Fair Value</b>
Available-for-sale:		
One year or less	\$ 5,824	\$ 5,860
Over one year to five years	17,465	18,086
Over five years to ten years	4,822	4,723
More than ten years		
<b>Total fixed maturities</b>	<b>\$ 28,111</b>	<b>\$ 28,669</b>

The following reflects the change in net unrealized gain on securities included as a separate component of AOCI in the condensed consolidated statements of equity (in thousands):

	<b>For the Three Months Ended March 31,</b>	
	<b>2011</b>	<b>2010</b>
Fixed maturities, net	\$ 73	\$ 1
Equity securities, net	72	26
Mutual and bond funds	(49)	129
<b>Change in net unrealized gain on available-for-sale securities</b>	<b>96</b>	<b>156</b>
Money market funds restricted	5	20
<b>Change in net unrealized gain on securities</b>	<b>\$ 101</b>	<b>\$ 176</b>

The components of net unrealized gain on securities consist of the following (in thousands):

	<b>For the Three Months Ended March 31,</b>	
	<b>2011</b>	<b>2010</b>
Net unrealized holding gain arising during the period	\$ 96	\$ 156
Reclassification adjustment for net realized losses included in net income		
<b>Net unrealized gain on available-for-sale securities</b>	<b>96</b>	<b>156</b>

Net unrealized holding gain arising during the period	restricted		5		20
Net unrealized gain on securities		\$	101	\$	176

**NOTE 13. DERIVATIVE INSTRUMENTS**

The following disclosures summarize the fair value of derivative instruments not designated as hedging instruments in the condensed consolidated balance sheets and the effect of changes in fair value related to those derivative instruments not designated as hedging instruments on the condensed consolidated statements of income.

**Derivative Instruments Not Designated**

As Hedging Instruments	Balance Sheet Location	Fair Value as of	
		March 31, 2011	December 31, 2010
		(In thousands)	
<b>Asset Derivatives:</b>			
Note Hedge	Other noncurrent assets	\$ 103,163	\$ 112,400
<b>Liability Derivatives:</b>			
Cash Conversion Option	Long-term debt	\$ 105,482	\$ 115,994
Contingent interest features of the Debentures and 3.25% Notes	Other noncurrent liabilities	\$ 0	\$ 0

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

<b>Effect on Income of Derivative Instruments Not Designated As Hedging Instruments</b>	<b>Location of Gain or (Loss) Recognized in Income on Derivatives</b>	<b>Amount of Gain or (Loss) Recognized in Income on Derivative For the Three Months Ended March 31,</b>	
		<b>2011 (In thousands)</b>	<b>2010</b>
Note Hedge	Non-cash convertible debt related expense	\$ (9,237)	\$ (36,896)
Cash Conversion Option	Non-cash convertible debt related expense	10,512	38,818
Contingent interest features of the 3.25% Notes and Debentures	Non-cash convertible debt related expense		
Effect on income of derivative instruments not designated as hedging instruments		\$ 1,275	\$ 1,922

**Cash Conversion Option, Note Hedge and Contingent Interest features related to the 3.25% Cash Convertible Senior Notes**

The Cash Conversion Option is a derivative instrument which is recorded at fair value quarterly with any change in fair value being recognized in our condensed consolidated statements of income as non-cash convertible debt related expense. The Note Hedge is accounted for as a derivative instrument and as such, is recorded at fair value quarterly with any change in fair value being recognized in our condensed consolidated statements of income as non-cash convertible debt related expense.

We expect the gain or loss associated with changes to the valuation of the Note Hedge to substantially offset the gain or loss associated with changes to the valuation of the Cash Conversion Option. However, they will not be completely offsetting as a result of changes in the credit valuation adjustment related to the Note Hedge. Our most significant credit exposure arises from the Note Hedge. The fair value of the Note Hedge reflects the maximum loss that would be incurred should the Option Counterparties fail to perform according to the terms of the Note Hedge agreement. For specific details related to the Cash Conversion Option, Note Hedge and contingent interest features of the 3.25% Notes, refer to Note 12 of the Notes to Consolidated Financial Statements in our Form 10-K.

**Contingent Interest feature of the 1.00% Senior Convertible Debentures**

The contingent interest feature in the Debentures is an embedded derivative instrument. The first contingent cash interest payment period would not commence until February 1, 2012, and the fair value for the embedded derivative was zero as of March 31, 2011. For specific criteria related to the contingent interest features of the Debentures, refer to Note 12 of the Notes to Consolidated Financial Statements in our Form 10-K.

## **Energy Price Risk**

Following the expiration of certain long-term energy sales contracts, we may have exposure to market risk, and therefore revenue fluctuations, in energy markets. We may enter into contractual arrangements that will mitigate our exposure to this volatility through a variety of hedging techniques. Our efforts in this regard will involve only mitigation of price volatility for the energy we produce, and will not involve speculative energy trading. Consequently, we have entered into swap agreements with various financial institutions to hedge our exposure to market risk. As of March 31, 2011, the fair value of the energy derivatives of \$0.6 million, pre-tax, was recorded as a current liability and as a component of AOCI.

## **NOTE 14. COMMITMENTS AND CONTINGENCIES**

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



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

**Environmental Matters**

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

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

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

*Wallingford Matter.* In 2010, compliance stack testing indicated that one of the three combustion units at the Wallingford energy-from-waste facility had exceeded the permit limit for dioxin/furan emissions. We promptly shut down the affected combustion unit and self-reported the test results to the Connecticut Department of Environmental Protection ( CTDEP ). On August 18, 2010, the Connecticut Office of the Attorney General ( AG ), on behalf of the CTDEP, commenced an enforcement action in Connecticut Superior Court (Hartford) with respect to the results of the compliance stack testing. We are working cooperatively with the CTDEP and AG to reach agreement on a restart and test program to demonstrate that the affected combustion unit has been returned to compliance. It is not possible at this time to predict the outcome or to estimate our ultimate liability in the matter; however, we believe this proceeding and related suspension in operation will not have a material adverse effect on our condensed consolidated financial position or results of operations.

*Lower Passaic River Matter.* In August 2004, the United States Environmental Protection Agency ( EPA ) notified Covanta Essex Company ( Essex ) that it was a potentially responsible party ( PRP ) for Superfund response actions in the Lower Passaic River Study Area, referred to as LPRSA, a 17 mile stretch of river in northern New Jersey. Essex is one of 71 PRPs named thus far that have joined the LPRSA PRP group, which is undertaking a Remedial Investigation/Feasibility Study ( Study ) of the LPRSA under EPA oversight. Essex's share of the Study costs to date are not material to its financial position and results of operations; however, the Study costs are exclusive of any LPRSA remedial costs or natural resource damages that may ultimately be assessed against PRPs. In February 2009, Essex and over 300 other PRPs were named as third-party defendants in a suit brought by the State of New Jersey Department of Environmental Protection ( NJDEP ) in New Jersey Superior Court of Essex County against Occidental Chemical Corporation and certain related entities ( Occidental ) with respect to alleged contamination of the LPRSA by Occidental. The Occidental third-party complaint seeks contribution with respect to any award to NJDEP of damages against Occidental in the matter. Considering the history of industrial and other discharges into the LPRSA from other sources, including named PRPs, Essex believes any releases to the LPRSA from its facility to be de minimis;

however, it is not possible at this time to predict that outcome or to estimate Essex's ultimate liability in the matter, including for LPRSA remedial costs and/or natural resource damages and/or contribution claims made by Occidental and/or other PRPs.

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

**Other Matters**

Other commitments as of March 31, 2011 were as follows (in thousands):

	<b>Commitments Expiring by Period</b>		
	<b>Total</b>	<b>Less Than One Year</b>	<b>More Than One Year</b>
Letters of credit	\$ 286,239	\$ 8,270	\$ 277,969
Surety bonds	85,889		85,889
Total other commitments net	\$ 372,128	\$ 8,270	\$ 363,858

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

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

The surety bonds listed on the table above relate primarily to performance obligations (\$74.8 million) and support for closure obligations of various energy projects when such projects cease operating (\$11.1 million). Were these bonds to be drawn upon, we would have a contractual obligation to indemnify the surety company.

We have certain contingent obligations related to the 7.25% Notes and the 3.25% Notes. These arise as follows:

- holders may require us to repurchase their 7.25% Notes and their 3.25% Notes if a fundamental change occurs; and
- holders may exercise their conversion rights upon the occurrence of certain events, which would require us to pay the conversion settlement amount in cash.

We have certain contingent obligations related to the Debentures. These arise as follows:

- holders may require us to repurchase their Debentures on February 1, 2012, February 1, 2017 and February 1, 2022;
- holders may require us to repurchase their Debentures if a fundamental change occurs; and

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

For specific criteria related to contingent interest, conversion or redemption features of the Debentures, the 7.25% Notes and the 3.25% Notes, refer to Note 12 of the Notes to Consolidated Financial Statements in our Form 10-K.

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

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

claim against a guarantee is made, the amounts owed pursuant to one or more of such guarantees could be greater than our then-available sources of funds. To date, we have not incurred material liabilities under such guarantees.

**NOTE 15. SUBSEQUENT EVENT**

On April 13, 2011, we signed an agreement with Samayanallur Power Investments Private Limited ( SPI ) to sell our interests in the 106 MW (gross) heavy fuel-oil fired electric power generation facility in Tamil Nadu, India ( Madurai ). The Madurai assets being sold include our entire interest in Covanta Madurai Operating Private Limited, which provides operation and maintenance services to the facility, as well as our approximately 77% ownership interest in the project company, Madurai Power Corporation Private Ltd. This transaction is expected to close in the next several months, subject to customary approvals and closing conditions and to SPI s obtaining financing.

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

The terms we, our, ours, us, Covanta and Company refer to Covanta Holding Corporation and its subsidiaries. The term Covanta Energy refers to our subsidiary Covanta Energy Corporation and its subsidiaries. The following discussion addresses our financial condition as of March 31, 2011 and our results of operations for the three months ended March 31, 2011, compared with the same periods last year. It should be read in conjunction with our Audited Consolidated Financial Statements and Notes thereto for the year ended December 31, 2010 and Management's Discussion and Analysis of Financial Condition and Results of Operations included in our Form 10-K for the year ended December 31, 2010 ( Form 10-K ), to which the reader is directed for additional information.

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

**OVERVIEW**

We are 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 ), as well as other waste disposal and renewable energy production businesses. Energy-from-waste serves two key markets as both a sustainable waste disposal 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.

We operate and/or have ownership positions in 44 energy-from-waste facilities, which are primarily located in North America, and 18 additional energy generation facilities, including other renewable energy production facilities in North America (wood biomass, landfill gas and hydroelectric) and independent power production ( IPP ) facilities in Asia. We also operate waste management infrastructure that is complementary to our core EfW business. We have one reportable segment which is Americas and we are organized as a holding company and conduct all of our operations through subsidiaries which are engaged predominantly in the businesses of waste and energy services.

We also hold equity interests in energy-from-waste facilities in China and Italy. We are pursuing additional growth opportunities in parts of Europe, where the market demand, regulatory environment or other factors encourage technologies such as energy-from-waste to reduce dependence on landfilling for waste disposal and fossil fuels for energy production in order to reduce greenhouse gas emissions. We are focusing primarily on the United Kingdom where we continue to pursue several billion dollars worth of energy-from-waste development opportunities.

In 2010, we adopted a plan to sell our interests in our fossil fuel independent power production facilities in the Philippines, India, and Bangladesh. During the first quarter of 2011, we completed the sale of our interests in a 510 megawatt ( MW ) (gross) coal-fired electric power generation facility in the Philippines ( Quezon ) and we completed the sale of our majority equity interests in a 106 MW (gross) heavy fuel-oil fired electric power generation facilities in Tamil Nadu, India ( Samalpatti ). In April 2011, we signed an agreement to sell our majority equity interests in our 106 MW (gross) heavy fuel-oil fired electric power generation facility also in Tamil Nadu, India ( Madurai ). The remaining asset held for sale is our equity interest in a barge-mounted 126 MW (gross) diesel/natural gas-fired electric power generation facility located near Haripur, Bangladesh. For additional information, see *Assets Held for Sale*

below.

We plan to allocate capital to maximize shareholder value by investing in high value core business development projects and strategic acquisitions when available, and by returning surplus capital to shareholders. On March 14, 2011, the Board of Directors approved a regular cash dividend of \$0.075 per share. The dividend was paid on April 12, 2011 to stockholders of record as of the close of business on March 30, 2011. On March 14, 2011, the Board of Directors approved an additional \$50 million of share repurchase authorization, bringing the total authorized amount to \$200 million. During the three months ended March 31, 2011, we repurchased 3.2 million shares of our common stock at a weighted average

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cost of \$16.84 per share for an aggregate amount of approximately \$54.4 million. For additional information, see *Liquidity and Capital Resources* below.

### **Strategy**

Our mission is to be the leading energy-from-waste company in the world, which we intend to pursue through the following key strategies:

*Maximize the value of our existing portfolio.* We intend to maximize the long-term value of our existing portfolio by continuing to operate at our historic production levels, maintaining our facilities in optimal condition through our ongoing maintenance programs, managing our expenses, extending or replacing waste and service contracts upon their expiration, seeking incremental revenue opportunities with our existing assets, relationships or technologies and expanding facility capacity where appropriate.

*Grow in selected attractive markets.* We seek to grow our portfolio primarily through the development of new facilities and acquisitions where we believe that market and regulatory conditions will enable us to invest our capital at attractive risk-adjusted rates of return. We are currently focusing on development opportunities in the U.S., Canada and Europe, which we consider to be our core markets. We believe that there are numerous attractive opportunities in the United Kingdom in particular, where national policies, such as a substantial tax on landfill use, are intended to achieve compliance with the EU Landfill Directive.

We believe that our approach to development opportunities is highly-disciplined, both with regard to our required rates of return and the manner in which potential new projects will be structured and financed. In general, prior to the commencement of construction of a new facility, we intend to enter into long-term contracts with municipal and/or commercial customers for a substantial portion of the disposal capacity and obtain non-recourse project financing for a majority of the capital investment. We intend to finance new projects in a prudent manner, minimizing the impact on our balance sheet and credit profile at the parent company level where possible.

*Develop and commercialize new technology.* We believe that our efforts to protect and expand our business will be enhanced by the development of additional technologies in such fields as emission controls, residue disposal, alternative waste treatment processes, and combustion controls. We have advanced our research and development efforts in these areas, and have developed and have patents pending for major advances in controlling nitrogen oxide ( NO<sub>x</sub> ) emissions and have a patent for a proprietary process to improve the handling of the residue from our energy-from-waste facilities. We have also entered into various agreements with multiple partners to invest in the development, testing or licensing of new technologies related to the transformation of waste materials into renewable fuels or the generation of energy, as well as improved environmental performance.

*Advocate for public policy favorable to energy-from-waste.* We seek to educate policymakers about the environmental and economic benefits of energy-from-waste and advocate for policies that appropriately reflect these benefits. Energy-from-waste is a highly regulated business, and as such we believe that it is critically important for us, as an industry leader, to play an active role in the debates surrounding potential policy developments that could impact our business.

We are actively engaged in the current discussion among policy makers in the United States regarding the benefits of energy-from-waste and the reduction of our dependence on landfilling for waste disposal and fossil fuels for energy. Given the recent economic slowdown and related unemployment, policy makers are focused on themes of economic stimulus, job creation, and energy security. We believe that the construction and permanent jobs created by additional energy-from-waste development represent the type of "green jobs" that are consistent with this focus.



*Allocate capital efficiently.* We plan to allocate capital to maximize shareholder value by investing in high value core business development projects and strategic acquisitions when available, and by returning surplus capital to shareholders.

**Factors Affecting Business Conditions and Financial Results**

**Economic** - During 2008 and 2009, the economic slowdown reduced demand for goods and services generally, which reduced overall volumes of waste requiring disposal and the pricing at which we can attract waste to fill

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available capacity. We receive the majority of our revenue under short- and long-term contracts, with little or no exposure to price volatility, but with adjustments intended to reflect changes in our costs. Where our revenue is received under other arrangements and depending upon the revenue source, we have varying amounts of exposure to price volatility.

The largest component of our revenue is waste revenue, which has generally been subject to less price volatility than our revenue derived from the sale of energy and metals. However, the downturn in economic activity has reduced waste generation rates in the northeast U.S. which subsequently caused market waste disposal prices to modestly decline. Furthermore, global demand and pricing of certain commodities, such as the scrap metals we recycle from our energy-from-waste facilities has been materially affected by economic activity. Pricing for recycled metals reached historically high levels during 2008, declined materially during 2009 and has rebounded substantially during 2010 and 2011.

At the same time, the declines in U.S. natural gas prices have pushed electricity and steam pricing lower generally, which causes lower revenue for the portion of the energy we sell which is not under fixed-price contracts. During 2008, pricing for energy reached historically high levels and has subsequently declined materially during both 2009 and 2010. During 2011, pricing for energy has modestly increased.

The downturn in economic activity has also affected many municipalities and public authorities, some of which are our customers. Many local and central governments are seeking to reduce expenses in order to address declining tax revenues. We work closely with these municipal customers, with many of whom we've shared a long-term relationship, to effectively counter some of these economic challenges.

***Market Pricing for Waste, Energy and Metal*** - Global and regional economy activity, as well as technological advances, regulations and a variety of other factors, will affect market supply and demand and therefore prices for waste disposal services, energy (including electricity and steam) and other commodities such as ferrous and non-ferrous metals. As market prices for waste disposal, electricity, steam and recycled metal rise it benefits our existing business as well as our prospects for growth through expansions or new development. Conversely, market price declines for these services and commodities will adversely affect both our existing business and growth prospects.

***Seasonal*** - Our quarterly operating income within the same fiscal year, typically differs substantially due to seasonal factors, primarily as a result of the timing of scheduled plant maintenance. We typically conduct scheduled maintenance periodically each year, which requires that individual boiler and/or turbine units temporarily cease operations. During these scheduled maintenance periods, we incur material repair and maintenance expenses and receive less revenue until the boiler and/or turbine units resume operations. This scheduled maintenance typically occurs during periods of off-peak electric demand and/or lower waste volumes, which are our first, second and fourth fiscal quarters. The first quarter scheduled maintenance period is typically the most extensive, with the second and fourth quarters historically being at similar levels. Given these factors, we typically experience our lowest operating income from our projects during our first quarter of each year and our highest operating income during the third quarter of each year.

In addition, at certain of our project subsidiaries, distributions of excess earnings (above and beyond monthly operation and maintenance service payments) are subject to periodic tests of project debt service coverage or requirements to maintain minimum working capital balances. While these distributions occur throughout the year based upon the specific terms of the relevant project debt arrangements, they are typically highest in the fourth quarter. Our net cash provided by operating activities exhibits seasonal fluctuations as a result of the timing of these distributions, including a benefit in the fourth quarter compared to the first nine months of the year.

***Other Factors Affecting Performance*** We have historically performed our operating obligations without experiencing material unexpected service interruptions or incurring material increases in costs. In addition, with respect to many of our contracts, we generally have limited our exposure for risks not within our control. For additional information about such risks and damages that we may owe for unexcused operating performance failures, see *Item 1A. Risk Factors*. In monitoring and assessing the ongoing operating and financial performance of our businesses, we focus on certain key factors: tons of waste processed, electricity and steam sold, and boiler availability.

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**Business Segment**

We have one reportable segment which is Americas and is comprised of waste and energy services operations primarily in the United States and Canada.

The Americas segment is comprised primarily of energy-from-waste projects. For all of these projects, we earn revenue from two primary sources: fees charged for operating projects or processing waste received and payments for electricity and steam sales. We also operate, and in some cases have ownership interests in, transfer stations and landfills which generate revenue from waste and ash disposal fees or operating fees. In addition, we own and in some cases operate, other renewable energy projects primarily in the United States which generate electricity from wood waste (biomass), landfill gas and hydroelectric resources. The electricity from these other renewable energy projects is sold to utilities. We may receive additional revenue from construction activity during periods when we are constructing new facilities or expanding existing facilities.

**Contract Structures**

We currently operate energy-from-waste projects in 16 states and Canada. Most of our energy-from-waste projects were developed and structured contractually as part of competitive procurement processes conducted by municipal entities. As a result, many of these projects have common features. However, each service agreement is different reflecting the specific needs and concerns of a client community, applicable regulatory requirements and other factors. The following describes features generally common to these agreements, as well as important distinctions among them:

We design the facility, help to arrange for financing and then we either construct and equip the facility on a fixed price and schedule basis, or we undertake an alternative role, such as construction management, if that better meets the goals of our municipal client.

For the energy-from-waste projects we own, financing is generally accomplished through tax-exempt and taxable revenue bonds issued by or on behalf of the client community. For these facilities, the bond proceeds are loaned to us to pay for facility construction and to fund a debt service reserve for the project, which is generally sufficient to pay principal and interest for one year. Project-related debt is included as project debt and the debt service reserves are included as restricted funds held in trust in our condensed consolidated financial statements. Generally, project debt is secured by the project's revenue, contracts and other assets of our project subsidiary.

Following construction and during operations, we receive revenue from two primary sources: fees we receive for operating projects or for processing waste received, and payments we receive for electricity and/or steam we sell.

We agree to operate the facility and meet minimum waste processing capacity and efficiency standards, energy production levels and environmental standards. Failure to meet these requirements or satisfy the other material terms of our agreement (unless the failure is caused by our client community or by events beyond our control), may result in damages charged to us or, if the breach is substantial, continuing and unremedied, termination of the applicable agreement. These damages could include amounts sufficient to repay project debt (as reduced by amounts held in trust and/or proceeds from sales of facilities securing project debt) and as such, these contingent obligations cannot readily be quantified. We have issued performance guarantees to our client communities and, in some cases other parties, which guarantee that our project subsidiaries will perform in accordance with contractual terms including, where required, the payment of such damages. If one or more contracts were terminated for our default, these contractual damages may be material to our cash flow and

financial condition. To date, we have not incurred material liabilities under such performance guarantees.

The client community generally must deliver minimum quantities of municipal solid waste to the facility on a put-or-pay basis and is obligated to pay a fee for its disposal. A put-or-pay commitment means that the client community promises to deliver a stated quantity of waste and pay an agreed amount for its disposal, regardless of whether the full amount of waste is actually delivered. Client communities have consistently met their commitment to deliver the stated quantity of waste. Where a Service Fee structure exists, portions of the service fee escalate to reflect indices for inflation, and in many cases, the client community must also pay for other costs, such as insurance, taxes, and transportation and disposal of the ash residue to the disposal site. Generally, expenses resulting from the delivery of unacceptable and hazardous waste on the site are also borne by the client community. In addition, the contracts generally require the client community to pay increased expenses and capital costs

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resulting from unforeseen circumstances, subject to specified limits. At three publicly-owned facilities we operate, our client community may terminate the operating contract under limited circumstances without cause.

Our returns are expected to be stable if we do not incur material unexpected operation and maintenance costs or other expenses. In addition, most of our energy-from-waste project contracts are structured so that contract counterparties generally bear, or share in, the costs associated with events or circumstances not within our control, such as uninsured force majeure events and changes in legal requirements. The stability of our revenues and returns could be affected by our ability to continue to enforce these obligations. Also, at some of our energy-from-waste facilities, commodity price risk is mitigated by passing through commodity costs to contract counterparties. With respect to our other renewable energy projects, such structural features generally do not exist because either we operate and maintain such facilities for our own account or we do so on a cost-plus basis rather than a fixed-fee basis.

We receive the majority of our revenue under short- and long-term contracts, with little or no exposure to price volatility, but with adjustments intended to reflect changes in our costs. Where our revenue is received under other arrangements and depending upon the revenue source, we have varying amounts of exposure to price volatility. The largest component of our revenue is waste revenue, which has generally been subject to less price volatility than our revenue derived from the sale of energy and metals. During 2008, pricing for energy reached historically high levels and has subsequently declined materially during both 2009 and 2010. During 2011, pricing for energy has modestly increased. Similarly, pricing for recycled metals reached historically high levels during 2008, declined materially during 2009 and has rebounded substantially during 2010 and 2011. At some of our renewable energy projects, our operating subsidiaries purchase fuel in the open markets which exposes us to fuel price risk.

We generally sell the energy output from our projects to local utilities pursuant to long-term contracts. At several of our energy-from-waste projects, we sell energy output under short-term contracts or on a spot-basis to our customers.

**Contracted and Merchant Capacity**

Our service and waste disposal agreements, as well as our energy contracts, expire at various times. The extent to which any such expiration will affect us will depend upon a variety of factors, including whether we own the project, market conditions then prevailing, and whether the municipal client exercises options it may have to extend the contract term. As our contracts expire, we will become subject to greater market risk in maintaining and enhancing our revenues. As service agreements at municipally-owned facilities expire, we intend to seek to enter into renewal or replacement contracts to operate such facilities. We will also seek to bid competitively in the market for additional contracts to operate other facilities as similar contracts of other vendors expire. As our service and waste disposal agreements at facilities we own or lease expire, we intend to seek replacement or additional contracts, and because project debt on these facilities will be paid off at such time, we expect to be able to offer rates that will attract sufficient quantities of waste while providing acceptable revenues to us. At facilities we own, the expiration of existing energy contracts will require us to sell our output either into the local electricity grid at prevailing rates or pursuant to new contracts. We may enter into contractual arrangements that will mitigate our exposure to revenue fluctuations in energy markets through a variety of hedging techniques.

To date, we have been successful in extending a majority of our existing contracts to operate energy-from-waste facilities owned by municipal clients where market conditions and other factors make it attractive for both us and our municipal clients to do so. See *Growth and Development* discussion below for additional information. The extent to which additional extensions will be attractive to us and to our municipal clients who own their projects will depend upon the market and other factors noted above. However, we do not believe that either our success or lack of success

in entering into additional negotiated extensions to operate such facilities will have a material impact on our overall cash flow and profitability for the next several years.

As we seek to enter into extended or new contracts, we expect that medium- and long-term contracts for waste supply, at least for a substantial portion of facility capacity, will be available on acceptable terms in the marketplace. We also expect that medium- and long-term contracts for sales of energy will be less available than in the past. As a result, following the expiration of these long-term contracts, we expect to have on a relative basis more exposure to market risk, and therefore revenue fluctuations, in energy markets than in waste markets.

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In conjunction with our U.S. energy-from-waste business, we also own and/or operate 13 transfer stations, two ashfills and two landfills in the northeast United States, which we utilize to supplement and manage more efficiently the fuel and ash disposal requirements at our energy-from-waste operations. We provide waste procurement services to our waste disposal and transfer station facilities which have available capacity to receive waste. With these services, we seek to maximize our revenue and ensure that our energy-from-waste facilities are being utilized most efficiently, taking into account maintenance schedules and operating restrictions that may exist from time to time at each facility. We also provide management and marketing of ferrous and non-ferrous metals recovered from energy-from-waste operations, as well as services related to non-hazardous special waste destruction and ash residue management for our energy-from-waste projects.

## **Growth and Development**

We are focusing our efforts on operating our existing business and pursuing strategic growth opportunities through development and acquisitions with the goal of maximizing long-term stockholder return. We anticipate that a part of our future growth will come from investing in or acquiring additional energy-from-waste, waste disposal and renewable energy production businesses. We are pursuing additional growth opportunities particularly in locations where the market demand, regulatory environment or other factors encourage technologies such as energy-from-waste to reduce dependence on landfilling for waste disposal and fossil fuels for energy production in order to reduce greenhouse gas emissions. We are focusing on the United Kingdom, Ireland, Canada and the United States. Our growth opportunities include: new energy-from-waste and other renewable energy projects, existing project expansions, contract extensions, acquisitions, and businesses ancillary to our existing business, such as additional waste transfer, transportation, processing and disposal businesses. We also intend to maintain a focus on research and development of technologies that we believe will enhance our competitive position, and offer new technical solutions to waste and energy problems that augment and complement our business.

We have a growth pipeline and continue to pursue several billion dollars worth of energy-from-waste development opportunities. However, much remains to be done and there is substantial uncertainty relating to the bidding and permitting process for each project opportunity. If, and when, these development efforts are successful, we plan to invest in these projects to achieve an attractive return on capital particularly when leveraged with project debt which we intend to utilize for all of our development projects.

The following is a discussion of acquisitions and business development for 2011 and 2010. See *Item 1. Financial Statements Note 3. Acquisitions and Business Development* for additional information.

## **CONTRACT EXTENSIONS**

### **Fairfax County Energy-from-Waste Facility**

In August 2010, the service fee contract with Fairfax County was extended from 2011 to 2016 pursuant to a unilateral option held by the County. The terms of the contract remain unchanged under the extension; however, the project debt on the facility was repaid in February 2011, and since Fairfax County had previously paid debt service as a component of the service fee during the term of the original contract, the County will effectively retain the benefit of the debt repayment during the 5 year extension period. In March 2011, the County announced its desire to proceed to negotiate a long term extension to the contract rather than exercise a fair market value purchase option it holds under the existing agreement. The parties are currently working to complete the contract extension.

## **ACQUISITIONS**

### **Dade Energy-from-Waste Business**



In February 2010, we completed a transaction with Veolia Environmental Services North America Corp. ( Veolia ) in which we paid cash consideration of \$128.3 million for an energy-from-waste business located in Florida. The operations acquired included a long-term operating contract with the respective municipal client.

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**PROJECTS UNDER ADVANCED DEVELOPMENT OR CONSTRUCTION**

**Americas**

**Durham-York Energy-from-Waste Facility**

In 2009, we were selected as the preferred vendor for the design, construction and operation of a municipally-owned 140,000 tonne-per-year greenfield energy-from-waste facility to be built in Clarington, Ontario, located in Durham Region, Canada. After receiving the Environmental Assessment from the Provincial Ministry of the Environment, we executed a project agreement with the Regions of Durham and York to design, build and operate the facility which will process waste from these Regions. The fixed construction contract price for the project is approximately C\$247 million. The project will be funded and owned by the Durham and York Regions. Covanta is in the process of obtaining the required permits and authorizations, and construction is expected to commence late in 2011 after these final authorizations are received. After successful construction, we will operate the facility under a 20 year contract.

**Honolulu Energy-from-Waste Facility**

We operate and maintain the energy-from-waste facility located in and owned by the City and County of Honolulu, Hawaii. In December 2009, we entered into agreements with the City and County of Honolulu to expand the facility's waste processing capacity from 2,160 tons per day ( tpd ) to 3,060 tpd and to increase gross electricity capacity from 57 MW to 90 MW. The agreements also extend the contract term by 20 years. The \$302 million expansion project is a fixed-price construction contract which is funded and owned by the City and County of Honolulu. Construction commenced at the end of 2009.

**Other**

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

We currently own 85% of the Taixing Covanta Yanjiang Cogeneration Co., Ltd. which, in 2009, entered into a 25 year concession agreement and waste supply agreements to build, own and operate a 350 metric tpd energy-from-waste facility for Taixing Municipality, in Jiangsu Province, People's Republic of China. The project, which will be built on the site of our existing coal-fired facility in Taixing, will supply steam to an adjacent industrial park under short-term arrangements. We will continue to operate our existing coal-fired facility. The project company has obtained Rmb 163 million in project financing which, together with available cash from existing operations will fund construction costs. Construction commenced in late 2009.

In 2008, we and Chongqing Iron & Steel Company (Group) Ltd. entered into an agreement to build, own, and operate an 1,800 metric tpd energy-from-waste facility for Chengdu Municipality in Sichuan Province, People's Republic of China. We also executed a 25 year waste concession agreement for this project. In connection with this project, we acquired a 49% equity interest in the project company. Construction of the facility has commenced and the project company has obtained Rmb 480 million in project financing, of which 49% is guaranteed by us and 51% is guaranteed by Chongqing Iron & Steel Company (Group) Ltd. until the project has been constructed and for one year after operations commence.

**ASSETS HELD FOR SALE**

In 2010, we adopted a plan to sell our interests in our fossil fuel independent power production facilities in the Philippines, India, and Bangladesh.

During the first quarter of 2011, we completed the sale of our majority equity interests in a 106 MW (gross) heavy fuel-oil fired electric power generation facilities in Tamil Nadu, India ( Samalpatti ) and we completed the sale of our interests in a 510 MW (gross) coal-fired electric power generation facility in the Philippines ( Quezon ). The Quezon assets sold consisted of our entire interest in Covanta Philippines Operating, Inc., which provided operation and maintenance services to the facility, as well as our 26% ownership interest in the project company, Quezon Power, Inc. We received a combined total of cash proceeds of approximately \$225 million, net of transaction costs.

In April 2011, we signed an agreement with Samayanallur Power Investments Private Limited ( SPI ) to sell our interests in the 106 MW (gross) heavy fuel-oil fired electric power generation facility in Tamil Nadu, India ( Madurai ). The Madurai assets being sold include our entire interest in Covanta Madurai Operating Private Limited, which provides operation and maintenance services to the facility, as well as our approximately 77% ownership interest in the project

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company, Madurai Power Corporation Private Ltd. This transaction is expected to close in the next several months, subject to customary approvals and closing conditions and to SPI's obtaining financing.

The remaining asset held for sale is our equity interest in a barge-mounted 126 MW (gross) diesel/natural gas-fired electric power generation facility located near Haripur, Bangladesh.

The assets and liabilities associated with these businesses are presented in our condensed consolidated balance sheets as *Current Assets Held for Sale* and *Current Liabilities Held for Sale*. The results of operations of these businesses are included in the condensed consolidated statements of operations as *Income (loss) earnings from discontinued operations, net of tax*. The cash flows of these businesses are also presented separately in our condensed consolidated statements of cash flows. All corresponding prior year periods presented in our condensed consolidated financial statements and accompanying notes have been reclassified to reflect the discontinued operations presentation. See *Item 8. Financial Statements And Supplementary Data Note 4. Assets Held for Sale and Dispositions* for additional information.

**RESULTS OF OPERATIONS**

The comparability of the information provided below with respect to our revenues, expenses and certain other items for the periods presented was affected by several factors. As outlined above under *Overview Growth and Development*, our acquisition and business development initiatives resulted in various additional projects which increased comparative revenues and expenses. These factors must be taken into account in developing meaningful comparisons between the periods compared below.

**RESULTS OF OPERATIONS Three Months Ended March 31, 2011 vs. Three Months Ended March 31, 2010**

	<b>For the Three Months Ended March 31,</b>		<b>Increase (Decrease)</b>
	<b>2011</b>	<b>2010</b>	<b>2011 vs 2010</b>
	<b>(Unaudited, in thousands)</b>		
<b>CONSOLIDATED RESULTS OF OPERATIONS:</b>			
Total operating revenues	\$ 376,770	\$ 367,693	\$ 9,077
Total operating expenses	378,412	372,074	6,338
Operating loss	(1,642)	(4,381)	(2,739)
Other income (expense):			
Investment income	261	223	38
Interest expense	(16,761)	(10,586)	6,175
Non-cash convertible debt related expense	(5,160)	(8,247)	(3,087)
Loss on extinguishment of debt	(356)		356
Total other expenses	(22,016)	(18,610)	3,406
Loss from continuing operations before income tax benefit and equity in net income (loss) from unconsolidated investments	(23,658)	(22,991)	667
Income tax benefit	9,986	9,882	104

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Equity in net income (loss) from unconsolidated investments	123	(1,342)	1,465
Loss from continuing operations	(13,549)	(14,451)	(902)
Income from discontinued operations (including net gain on disposal of assets held for sale of \$135,601 in 2011), net of taxes of \$2,193 and \$2,007, respectively	148,942	9,718	139,224
<b>NET INCOME (LOSS)</b>	<b>135,393</b>	<b>(4,733)</b>	<b>140,126</b>
Less: Net income from continuing operations attributable to noncontrolling interests in subsidiaries	(92)	(1,562)	(1,470)
Less: Net income from discontinued operations attributable to noncontrolling interests in subsidiaries	(1,808)	(938)	870
Total Net income attributable to noncontrolling interests in subsidiaries	(1,900)	(2,500)	(600)
<b>NET INCOME (LOSS) ATTRIBUTABLE TO COVANTA HOLDING CORPORATION</b>	<b>\$ 133,493</b>	<b>\$ (7,233)</b>	<b>140,726</b>
Amounts Attributable to Covanta Holding Corporation stockholders:			
Continuing operations	\$ (13,641)	\$ (16,013)	2,372
Discontinued operations, net of tax expense	147,134	8,780	138,354
Covanta Holding Corporation	\$ 133,493	\$ (7,233)	140,726

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	<b>For the Three Months Ended March 31,</b>		<b>Increase (Decrease)</b>
	<b>2011</b>	<b>2010</b>	<b>2011 vs 2010</b>
	<b>(Unaudited, in thousands)</b>		
Earnings (Loss) Per Share Attributable to Covanta Holding Corporation stockholders:			
Basic:			
Continuing operations	\$ (0.09)	\$ (0.10)	0.01
Discontinued operations	1.00	0.05	0.95
Covanta Holding Corporation	\$ 0.91	\$ (0.05)	0.96
Weighted Average Shares	146,859	153,894	(7,035)
Diluted:			
Continuing operations	\$ (0.09)	\$ (0.10)	0.01
Discontinued operations	1.00	0.05	0.95
Covanta Holding Corporation	\$ 0.91	\$ (0.05)	0.96
Weighted Average Shares	146,859	153,894	(7,035)
Cash Dividend Declared Per Share	\$ 0.075	\$	0.075
Adjusted Earnings Per Share Non-GAAP <sup>(A)</sup>	\$ (0.10)	\$ (0.11)	0.01

(A) See *Supplementary Financial Information Adjusted Earnings Per Share (Non-GAAP Discussion)*

The following general discussions should be read in conjunction with the above table, the condensed consolidated financial statements, the notes to the condensed consolidated financial statements and other financial information appearing and referred to elsewhere in this report. Additional detail relating to changes in operating revenues and operating expenses, and the quantification of specific factors affecting or causing such changes, is provided in the segment discussion below.

***Consolidated Results of Operations Comparison of Results for the Three Months Ended March 31, 2011 vs. Results for the Three Months Ended March 31, 2010***

Operating revenues increased by \$9.1 million primarily due to increased recycled metal revenues due to higher market prices; improved revenues from service fee contract escalations; a full quarter operating the Dade facility; and increased construction revenue due to the Honolulu expansion project. These increases were offset by the impact of lower electricity and steam sales due to lower pricing and lower production related to some biomass facilities being economically dispatched off-line.

Operating expenses increased by \$6.3 million primarily due to normal cost escalations, a full quarter operating the Dade facility, higher fuel related costs and increased construction expense related to the Honolulu expansion project. These increases were partially offset by lower costs related to some biomass facilities being economically dispatched off-line and higher alternative fuel tax credits.

Operating loss decreased by \$2.7 million primarily due to higher recycled metal revenues.

Interest expense increased by \$6.2 million primarily due to the issuance of the 7.25% Senior Notes which were issued in December 2010, offset by lower interest expense for the Debentures, the majority of which were tendered during the fourth quarter of 2010. Non-cash convertible debt related expense decreased by \$3.1 million primarily due to lower amortization of the debt discount for the Debentures and the net changes to the valuation of the derivatives associated with the 3.25% Cash Convertible Senior Notes.

The income tax benefit was flat for the comparative period which is reflective of the minimal change in pre-tax loss from continuing operations. We currently estimate our annual effective tax rate for the year ending December 31, 2011 to be approximately 42.6%. We review the annual effective tax rate on a quarterly basis as projections are revised and laws are enacted. The effective income tax rate was 42.2% and 43.0% for the three months ended March 31, 2011 and 2010, respectively.

On March 14, 2011, the Board of Directors approved a regular cash dividend of \$0.075 per share. The dividend was paid on April 12, 2011 to stockholders of record as of the close of business on March 30, 2011. On March 14, 2011, the Board of Directors approved an additional \$50 million of share repurchase authorization, bringing the total authorized amount to

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\$200 million. During the three months ended March 31, 2011, we repurchased 3.2 million shares of our common stock at a weighted average cost of \$16.84 per share for an aggregate amount of approximately \$54.4 million. For additional information, see *Liquidity* below.

***Americas Segment Results of Operations Comparison of Results for the Three Months Ended March 31, 2011 vs. Results for the Three Months Ended March 31, 2010***

	<b>For the Three Months Ended March 31, 2011                      2010</b>		<b>Increase (Decrease) 2011 vs 2010</b>
	<b>(Unaudited, in thousands)</b>		
Waste and service revenues	\$ 250,917	\$ 241,063	\$ 9,854
Electricity and steam sales	88,431	95,409	(6,978)
Other operating revenues	27,213	20,815	6,398
<b>Total operating revenues</b>	<b>366,561</b>	<b>357,287</b>	<b>9,274</b>
Plant operating expenses	263,709	257,182	6,527
Other operating expenses	23,425	20,614	2,811
General and administrative expenses	18,025	19,461	(1,436)
Depreciation and amortization expense	46,907	48,021	(1,114)
Net interest expense on project debt	7,963	10,282	(2,319)
<b>Total operating expenses</b>	<b>360,029</b>	<b>355,560</b>	<b>4,469</b>
<b>Operating income</b>	<b>\$ 6,532</b>	<b>\$ 1,727</b>	<b>4,805</b>

*Operating Revenues*

Operating revenues for the Americas segment increased by \$9.3 million.

Revenues increased by \$5.9 million primarily due to increases in service fee contract escalations, a full quarter operating the Dade facility and tip fee price increases.

Recycled metal revenues increased by \$4.0 million primarily due to higher pricing. Historically, we have experienced volatile prices for recycled metal which has affected our recycled metal revenue as reflected in the table below (in millions):

	<b>For the Quarters Ended</b>		
<b>Total Recycled Metal Revenues</b>	<b>2011</b>	<b>2010</b>	<b>2009</b>
March 31,	\$ 16.6	\$ 12.6	\$ 5.2
June 30,		14.8	5.8
September 30,		13.3	9.1



December 31,			13.9	9.1
Total for the Year Ended December 31,	\$	N/A	\$ 54.6	\$ 29.2

Electricity and steam sales decreased by \$7.0 million due to lower production of which \$5 million related to economically dispatching some of our biomass facilities and lower pricing.

Other operating revenues increased primarily due to increased construction revenue related to the Honolulu expansion project.

*Operating Expenses*

Plant operating expenses increased by \$6.5 million primarily due to normal cost escalations, a full quarter operating the Dade facility and higher fuel related costs, partially offset by lower costs of which \$5 million related to some biomass facilities being economically dispatched off-line and higher alternative fuel tax credits.

Other operating expenses increased primarily due to increased construction expense related to the Honolulu expansion project.

General and administrative expenses decreased primarily due to lower growth spending.

Net interest expense on project debt decreased due to lower project debt balances.

**Table of Contents***Operating Income*

Operating income increased by \$4.8 million primarily due to higher recycled metal revenues.

**Supplementary Financial Information – Adjusted Earnings Per Share ( Adjusted EPS ) (Non-GAAP Discussion)**

We use a number of different financial measures, both United States generally accepted accounting principles ( GAAP ) and non-GAAP, in assessing the overall performance of our business. To supplement our results prepared in accordance with GAAP, we use the measure of Adjusted EPS, which is a non-GAAP measure as defined by the Securities and Exchange Commission ( SEC ). The non-GAAP financial measure of Adjusted EPS is not intended as a substitute or as an alternative to diluted earnings (loss) per share as an indicator of our performance or any other measure of performance derived in accordance with GAAP. In addition, our non-GAAP financial measures may be different from non-GAAP measures used by other companies, limiting their usefulness for comparison purposes.

Adjusted EPS excludes certain income and expense items that are not representative of our ongoing business and operations, which are included in the calculation of diluted earnings (loss) per share in accordance with GAAP. The following items are not all-inclusive, but are examples of reconciling items in prior comparative and future periods. They would include write-down of assets, the effect of derivative instruments not designated as hedging instruments, significant gains or losses from the disposition of businesses, gains and losses on assets held for sale, transaction-related costs, income and loss on the extinguishment of debt and other significant items that would not be representative of our ongoing business.

We use the non-GAAP measure of Adjusted EPS to enhance the usefulness of our financial information by providing a measure which management internally uses to assess and evaluate the overall performance and highlight trends in the ongoing business.

In order to provide a meaningful basis for comparison, we are providing information with respect to our Adjusted EPS for the three months ended March 31, 2011 and 2010, reconciled for each such period to diluted earnings (loss) per share from continuing operations, which is believed to be the most directly comparable measure under GAAP (in thousands, except per share amounts and percentages):

	<b>Three Months Ended March 31,</b>	
	<b>2011</b>	<b>2010</b>
<b>Diluted Loss Per Share from Continuing Operations</b>	\$ (0.09)	\$ (0.10)
Reconciling Items <sup>(A)</sup>	(0.01)	(0.01)
<b>Adjusted EPS</b>	\$ (0.10)	\$ (0.11)

(A) Additional information is provided in the Reconciling Items table below.

	<b>Three Months Ended March 31,</b>	
	<b>2011</b>	<b>2010</b>
<b>Reconciling Items</b>		
Loss on extinguishment of debt	\$ 356	\$

Effect on income of derivative instruments not designated as hedging instruments		(1,275)		(1,923)
Transaction-related costs				235
Total reconciling items, pre-tax		(919)		(1,688)
Income tax impact		372		633
Grantor trust activity		(522)		(410)
Total reconciling items, net of tax	\$	(1,069)	\$	(1,465)
Diluted Loss Per Share Impact	\$	(0.01)	\$	(0.01)
Weighted Average Diluted Shares Outstanding		146,859		153,894

**Supplementary Financial Information – Adjusted EBITDA (Non-GAAP Discussion)**

To supplement our results prepared in accordance with GAAP, we use the measure of Adjusted EBITDA, which is a non-GAAP measure as defined by the SEC. This non-GAAP financial measure is described below, and is not intended as a substitute and should not be considered in isolation from measures of financial performance prepared in accordance with

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GAAP. In addition, our use of non-GAAP financial measures may be different from non-GAAP measures used by other companies, limiting their usefulness for comparison purposes. The presentation of Adjusted EBITDA is intended to enhance the usefulness of our financial information by providing a measure which management internally uses to assess and evaluate the overall performance of its business and those of possible acquisition candidates, and highlight trends in the overall business.

We use Adjusted EBITDA to provide further information that is useful to an understanding of the financial covenants contained in the credit facilities of our most significant subsidiary, Covanta Energy, through which we conduct our core waste and energy services business, and as additional ways of viewing aspects of its operations that, when viewed with the GAAP results and the accompanying reconciliations to corresponding GAAP financial measures, provide a more complete understanding of our core business. The calculation of Adjusted EBITDA is based on the definition in Covanta Energy's credit facilities as described below under *Liquidity and Capital Resources*, which we have guaranteed. Adjusted EBITDA is defined as earnings before interest, taxes, depreciation and amortization, as adjusted for additional items subtracted from or added to net income. Because our business is substantially comprised of that of Covanta Energy, our financial performance is substantially similar to that of Covanta Energy. For this reason, and in order to avoid use of multiple financial measures which are not all from the same entity, the calculation of Adjusted EBITDA and other financial measures presented herein are measured on a consolidated basis for continuing operations. Under these credit facilities, Covanta Energy is required to satisfy certain financial covenants, including certain ratios of which Adjusted EBITDA is an important component. Compliance with such financial covenants is expected to be the principal limiting factor which will affect our ability to engage in a broad range of activities in furtherance of our business, including making certain investments, acquiring businesses and incurring additional debt. Covanta Energy was in compliance with these covenants as of March 31, 2011. Failure to comply with such financial covenants could result in a default under these credit facilities, which default would have a material adverse affect on our financial condition and liquidity.

Adjusted EBITDA should not be considered as an alternative to net income or cash flow provided by operating activities as indicators of our performance or liquidity or any other measures of performance or liquidity derived in accordance with GAAP.

In order to provide a meaningful basis for comparison, we are providing information with respect to our Adjusted EBITDA for the three months ended March 31, 2011 and 2010, reconciled for each such period to net loss from continuing operations and cash flow provided by operating activities from continuing operations, which are believed to be the most directly comparable measures under GAAP.

The following is a reconciliation of net income to Continuing Operations - Adjusted EBITDA (in thousands):

		<b>For the Three Months Ended March 31,</b>	
		<b>2011</b>	<b>2010</b>
Net Loss Attributable to Covanta Holding Corporation	Continuing Operations	\$ (13,641)	\$ (16,013)
Depreciation and amortization expense		47,365	48,438
Debt service:			
Net interest expense on project debt		7,963	10,282
Interest expense		16,761	10,586
Non-cash convertible debt related expense		5,160	8,247
Investment income		(261)	(223)

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Subtotal debt service	29,623	28,892
Income tax benefit	(9,986)	(9,882)
Net income attributable to noncontrolling interests in subsidiaries	92	1,562
Loss on extinguishment of debt	356	
Other adjustments:		
Debt service billing in excess of revenue recognized <sup>(A)</sup>	11,265	10,803
Non-cash compensation expense	4,569	3,500
Transaction-related costs <sup>(B)</sup>		235
Other non-cash expenses <sup>(C)</sup>	1,639	1,137
Subtotal other adjustments	17,473	15,675
Total adjustments	84,923	84,685
<b>Continuing Operations - Adjusted EBITDA</b>	<b>\$ 71,282</b>	<b>\$ 68,672</b>

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- (A) Formally labeled *Decrease in Unbilled Service Receivables*. This amount represents a true-up between (a) revenue recognized in the period for client payments of project debt principal under service fee contract structures, which is accounted for on a straight-line basis over the term of the project debt, and (b) actual billings to clients for debt principal payments in the period. As result of this adjustment, Adjusted EBITDA reflects the actual amounts billed to clients for debt service principal, not the straight-lined revenue as recognized.
- (B) In 2010, this amount relates primarily to transaction costs associated with the acquisition of Veolia energy-from-waste businesses.
- (C) Includes certain non-cash items that are added back under the definition of Adjusted EBITDA in Covanta Energy's credit agreement.

The following is a reconciliation of cash flow provided by operating activities from continuing operations to Adjusted EBITDA (in thousands):

	<b>Three Months Ended March 31,</b>	
	<b>2011</b>	<b>2010</b>
Cash flow provided by operating activities from continuing operations	\$ 93,448	\$ 115,679
Debt service	29,623	28,892
Change in working capital	(71,186)	(88,767)
Change in restricted funds held in trust	14,748	12,027
Non-cash convertible debt related expense	(5,160)	(8,247)
Amortization of debt premium and deferred financing costs	(134)	169
Equity in net income from unconsolidated investments	123	(1,342)
Dividends from unconsolidated investments	(4,410)	(447)
Current tax provision	(534)	(1,341)
Other	14,764	12,049
Sub-total:	(51,789)	(75,899)
<b>Continuing Operations - Adjusted EBITDA</b>	<b>\$ 71,282</b>	<b>\$ 68,672</b>

For additional discussion related to management's use of non-GAAP measures, see *Liquidity and Capital Resources Supplementary Financial Information - Free Cash Flow (Non-GAAP Discussion)* below.

**LIQUIDITY AND CAPITAL RESOURCES**

We generate substantial cash flow from our ongoing business, which we believe will allow us to meet our liquidity needs. As of March 31, 2011, in addition to our ongoing cash flow, we had access to several sources of liquidity, as discussed in *Available Sources of Liquidity* below, including our existing cash on hand of \$326.6 million and the undrawn and available capacity of \$300 million of our Revolving Credit Facility. In addition, we had restricted cash of \$204.3 million, of which \$111.2 million was designated for future payment of project debt principal.

We derive our cash flows principally from our operations, which allow us to satisfy project debt covenants and payments and distribute cash. We typically receive cash distributions from our Americas segment projects on either a monthly or quarterly basis, whereas a material portion of cash from our international projects is received semi-annually, during the second and fourth quarters. The frequency and predictability of our receipt of cash from projects differs, depending upon various factors, including whether restrictions on distributions exist in applicable project debt arrangements, whether a project is domestic or international, and whether a project has been able to operate at historical levels of production.

Our primary future cash requirements will be to fund capital expenditures to maintain our existing businesses, make debt service payments, grow our business through acquisitions and business development, and return surplus capital to shareholders. We will also seek to enhance our cash flow from renewals or replacement of existing contracts, from new contracts to expand existing facilities or operate additional facilities and by investing in new projects. Our business is capital intensive because it is based upon building and operating municipal solid waste processing and energy generating projects. In order to provide meaningful growth through development, we must be able to invest our funds, obtain equity and/or debt financing, and provide support to our operating subsidiaries. The timing and scale of our investment activity in growth opportunities is often unpredictable and uneven. We plan to allocate capital to maximize shareholder value by

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investing in high value core business development projects and strategic acquisitions when available, and by returning surplus capital to shareholders. See *Overview Growth and Development* above.

On March 14, 2011, the Board of Directors approved a regular cash dividend of \$0.075 per share. The dividend was paid on April 12, 2011 to stockholders of record as of the close of business on March 30, 2011. In addition, pursuant to our Equity Plan, holders of unvested shares of restricted stock received a dividend in the form of additional restricted stock awards with the same vesting conditions as the underlying shares of restricted stock to which they relate.

On March 14, 2011, the Board of Directors approved an additional \$50 million of share repurchase authorization, bringing the total authorized amount to \$200 million. Under the program, common stock repurchases may be made in the open market, in privately negotiated transactions from time to time, or by other available methods, at management's discretion in accordance with applicable federal securities laws. The timing and amounts of any repurchases will depend on many factors, including our capital structure, the market price of our common stock and overall market conditions. During the three months ended March 31, 2011, we repurchased 3.2 million shares of our common stock at a weighted average cost of \$16.84 per share for an aggregate amount of approximately \$54.4 million. As of March 31, 2011, the amount remaining under our currently authorized share repurchase program was \$50.4 million.

**Sources and Uses of Cash Flow from Continuing Operations for the Three Months Ended March 31, 2011 and 2010:**

	<b>Three Months Ended March 31,</b>		<b>Increase (Decrease)</b>
	<b>2011</b>	<b>2010</b>	<b>2011 vs 2010</b>
	<b>(Unaudited, in thousands)</b>		
Net cash provided by operating activities	\$ 93,448	\$ 115,679	\$ (22,231)
Net cash used in investing activities	(33,836)	(184,193)	(150,357)
Net cash used in financing activities	(93,960)	(32,695)	61,265
Effect of exchange rate changes on cash and cash equivalents	1,506	(331)	1,837
Net decrease in cash and cash equivalents	\$ (32,842)	\$ (101,540)	(68,698)

Net cash provided by operating activities from continuing operations for the three months ended March 31, 2011 was \$93.4 million, a decrease of \$22.2 million from the prior year period. The decrease was primarily due to the timing of working capital.

Net cash used in investing activities from continuing operations for the three months ended March 31, 2011 was \$33.8 million, a decrease of \$150.4 million from the prior year period. The decrease was primarily comprised of lower cash outflows of \$128.3 million related to the acquisition of the Dade energy-from-waste facility in the first quarter of 2010.

Net cash used in financing activities from continuing operations for the three months ended March 31, 2011 was \$94.0 million, a net change of \$61.3 million. Net cash used in financing activities from continuing operations for the three months ended March 31, 2011 was primarily due to the repurchase of common stock of \$54.4 million and \$5.9 million paid to purchase outstanding Debentures in connection with the tender offer.



**Supplementary Financial Information – Free Cash Flow (Non-GAAP Discussion)**

To supplement our results prepared in accordance with GAAP, we use the measure of Free Cash Flow, which is a non-GAAP measure as defined by the SEC. This non-GAAP financial measure is not intended as a substitute and should not be considered in isolation from measures of liquidity prepared in accordance with GAAP. In addition, our use of Free Cash Flow may be different from similarly identified non-GAAP measures used by other companies, limiting their usefulness for comparison purposes. The presentation of Free Cash Flow is intended to enhance the usefulness of our financial information by providing measures which management internally uses to assess and evaluate the overall performance of its business and those of possible acquisition candidates, and highlight trends in the overall business.

We use the non-GAAP measure of Free Cash Flow as a criterion of liquidity and performance-based components of employee compensation. Free Cash Flow is defined as cash flow provided by operating activities from continuing operations less maintenance capital expenditures, which are capital expenditures primarily to maintain our existing facilities. We use the non-GAAP measure of Free Cash Flow as a criterion of liquidity and performance-based components of employee compensation. We use Free Cash Flow as a measure of liquidity to determine amounts we can reinvest in our businesses, such as amounts available to make acquisitions, invest in construction of new projects or

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make principal payments on debt. For additional discussion related to management's use of non-GAAP measures, see *Results of Operations - Supplementary Financial Information - Adjusted EBITDA (Non-GAAP Discussion)* above.

In order to provide a meaningful basis for comparison, we are providing information with respect to our Free Cash Flow for the three months ended March 31, 2011 and 2010, reconciled for each such periods to cash flow provided by operating activities from continuing operations, which we believe to be the most directly comparable measure under GAAP.

The following is a summary of Free Cash Flow and its primary uses (in thousands):

	<b>Three Months Ended March 31,</b>	
	<b>2011</b>	<b>2010</b>
Cash flow provided by operating activities of continuing operations	\$ 93,448	\$ 115,679
Less: Maintenance capital expenditures (A)	(27,197)	(32,539)
Continuing Operations Free Cash Flow	\$ 66,251	\$ 83,140
 <b><u>Uses of Continuing Operations Free Cash Flow</u></b>		
Free Cash Flow (Continuing Operations)	\$ 66,251	\$ 83,140
Net cash used for scheduled principal payments of project debt (B)	(30,812)	(31,724)
Net cash used for scheduled principal payments of long-term debt	(1,695)	(1,857)
Distributions to partners of noncontrolling interests in subsidiaries	(1,534)	(1,402)
Free cash flow available after scheduled payments:	\$ 32,210	\$ 48,157
 <b><u>Other Sources and Uses Cash</u></b>		
Investments:		
Acquisition of businesses, net of cash acquired	\$	\$ (128,254)
Non-maintenance capital expenditures	(11,095)	(5,378)
Acquisition of noncontrolling interests in subsidiary		(2,000)
Other investment activities, net (C)	4,456	(16,021)
Total investments	\$ (6,639)	\$ (151,653)
 Return of capital to stockholders:		
Common stock repurchased	\$ (54,371)	\$
Total return of capital to stockholders	\$ (54,371)	\$
 Capital raising activities:		
Net proceeds from issuance of project debt	\$ 2,169	\$
Other financing activities, net	(1,741)	5,487

Net proceeds from capital raising activities	\$ 428	\$ 5,487
Optional debt repayments:		
Optional repayment of corporate debt	\$ (5,883)	\$
Fees incurred for debt redemption	(93)	
Total optional debt repayments	\$ (5,976)	\$
Short-term borrowing activities:		
Financing of insurance premiums, net	\$	\$ (3,200)
Short-term borrowing activities, net	\$	\$ (3,200)
Effect of exchange rate changes on cash and cash equivalents	\$ 1,506	\$ (331)
<b>Net change in cash and cash equivalents from continuing operations</b>	<b>\$ (32,842)</b>	<b>\$ (101,540)</b>

(A) Purchases of property, plant and equipment is also referred to as capital expenditures. Capital expenditures that primarily maintain existing facilities are classified as maintenance capital expenditures. The following table provides the components of total purchases of property, plant and equipment:

Maintenance capital expenditures	\$ (27,197)	\$ (32,539)
Capital expenditures associated with project construction/development	(2,682)	(2,862)
Capital expenditures associated with technology development	(2,150)	(1,720)
Capital expenditures - other	(6,263)	(796)
Total purchases of property, plant and equipment	\$ (38,292)	\$ (37,917)

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(B) Calculated as follows:

	<b>Three Months Ended March 31,</b>	
	<b>2011</b>	<b>2010</b>
Total principal payments on project debt	\$ (74,471)	\$ (43,107)
Decrease in related restricted funds held in trust	43,659	11,383
Net cash used for principal payments on project debt	\$ (30,812)	\$ (31,724)

(C) For the three months ended March 31, 2011 and 2010, other investing activities was primarily comprised of net payments from the purchase/sale of investment securities and business development expenses.

**Available Sources of Liquidity*****Cash and Cash Equivalents***

Cash and cash equivalents include all cash balances and highly liquid investments having maturities of three months or less from the date of purchase. These short-term investments are stated at cost, which approximates market value. As of March 31, 2011, we had unrestricted cash and cash equivalents of \$326.6 million (of which approximately \$290.4 million and \$8.8 million was held by our international and insurance subsidiaries, respectively). Of the cash balance held internationally, we plan to repatriate at least \$100 million in a tax efficient manner and hold remaining funds off-shore with the intention of reinvesting them into the international business.

***Short-Term Liquidity***

We have credit facilities which are comprised of a \$300 million revolving credit facility (the Revolving Credit Facility), a \$320 million funded letter of credit facility (the Funded L/C Facility), and a \$650 million term loan (the Term Loan Facility) (collectively referred to as the Credit Facilities). As of March 31, 2011, we had available credit for liquidity as follows (in thousands):

	<b>Total Available Under Facility</b>	<b>Maturing</b>	<b>Outstanding Letters of Credit as of March 31, 2011</b>	<b>Available as of March 31, 2011</b>
Revolving Credit Facility(1)	\$ 300,000	2013	\$	\$ 300,000
Funded L/C Facility	\$ 320,000	2014	\$ 286,239	\$ 33,761

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

**Credit Agreement Financial Covenants**

The loan documentation under the Credit Facilities contains customary affirmative and negative covenants and financial covenants as discussed in Note 12. Long-Term Debt of the Notes to the Consolidated Financial Statements

included in our Form 10-K. As of March 31, 2011, we were in compliance with the covenants under the Credit Facilities. The maximum Covanta Energy capital expenditures that can be incurred in 2011 to maintain existing operating businesses is approximately \$230 million as of March 31, 2011.

**Table of Contents****Long-Term Debt**

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

	As of	
	March 31, 2011	December 31, 2010
7.25% Senior Notes due 2020	\$ 400,000	\$ 400,000
3.25% Cash Convertible Senior Notes due 2014	460,000	460,000
Debt discount related to Cash Convertible Senior Notes	(85,552)	(91,212)
Cash conversion option derivative at fair value	105,482	115,994
3.25% Cash Convertible Senior Notes, net	479,930	484,782
1.00% Senior Convertible Debentures due 2027	51,362	57,289
Debt discount related to Convertible Debentures	(2,588)	(3,720)
1.00% Senior Convertible Debentures, net	48,774	53,569
Term Loan Facility due 2014	624,000	625,625
Other long-term debt	364	435
Total	1,553,068	1,564,411
Less: current portion	(55,489)	(6,710)
Total long-term debt	\$ 1,497,579	\$ 1,557,701

***7.25% Senior Notes due 2020 (the 7.25% Notes )***

For specific criteria related to redemption features of the 7.25% Notes, refer to Note 12 of the Notes to Consolidated Financial Statements in our Form 10-K.

***3.25% Cash Convertible Senior Notes due 2014 (the 3.25% Notes )***

Under limited circumstances, the 3.25% Notes are convertible by the holders thereof into cash only, based on a conversion rate of 59.1871 shares of our common stock per \$1,000 principal amount of 3.25% Notes (which represents a conversion price of approximately \$16.90 per share) subject to certain customary adjustments as provided in the indenture for the 3.25% Notes. We will not deliver common stock (or any other securities) upon conversion under any circumstances.

For specific criteria related to contingent interest, conversion or redemption features of the 3.25% Notes and details related to the cash conversion option, cash convertible note hedge and warrants related to the 3.25% Notes, refer to Note 12 of the Notes to Consolidated Financial Statements in our Form 10-K.

For details related to the fair value for the contingent interest feature, cash conversion option, and cash convertible note hedge related to the 3.25% Notes, see Note 13. Derivative Instruments.

*1.00% Senior Convertible Debentures due 2027 (the Debentures )*

In November 2010, we commenced a tender offer to purchase for cash any and all of our outstanding 1.00% Senior Convertible Debentures due 2027. We offered to purchase the Debentures at a purchase price of \$990 for each \$1,000 principal amount of Debentures. During the three months ended March 31, 2011, an additional \$5.9 million of the Debentures were purchased for which we recorded a loss on extinguishment of debt of \$0.4 million, pre-tax. The loss on extinguishment of debt was comprised of the difference between the fair value and carrying value of the liability component of the Debentures tendered. As of March 31, 2011, there were \$51.4 million aggregate principal amount of the Debentures outstanding. We may purchase Debentures that remained outstanding following termination or expiration of the tender offer in the open market, in privately negotiated transactions, through tender offers, exchange offers, by redemption or otherwise.

Under limited circumstances, prior to February 1, 2025, the Debentures are convertible by the holders into cash and shares of our common stock, if any, based on a conversion rate of 38.9883 shares of our common stock per \$1,000 principal amount of Debentures, (which represents a conversion price of approximately \$25.65 per share) or 2,002,517 issuable shares. As of March 31, 2011, if the Debentures were converted, no shares would have been issued since the trading price of our common stock was below the conversion price of the Debentures.

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For specific criteria related to contingent interest, conversion or redemption features of the Debentures, refer to Note 12 of the Notes to Consolidated Financial Statements in our Form 10-K.

For details related to the fair value for the contingent interest feature related to the Debentures, see *Item 1. Financial Statements Note 13. Derivative Instruments*.

**Project Debt*****Americas Project Debt***

Financing for the energy-from-waste projects is generally accomplished through tax-exempt and taxable municipal revenue bonds issued by or on behalf of the municipal client. For such facilities that are owned by a subsidiary of ours, the municipal issuers of the bond loans the bond proceeds to our subsidiary to pay for facility construction. For such facilities, project-related debt is included as Project debt (short- and long-term) in our condensed consolidated financial statements. Generally, such project debt is secured by the revenues generated by the project and other project assets including the related facility. The only potential recourse to us with respect to project debt arises under the operating performance guarantees described below under *Other Commitments*. Certain subsidiaries had recourse liability for project debt which is recourse to our subsidiary Covanta ARC LLC, but is non-recourse to us, which as of March 31, 2011 aggregated to \$208.5 million.

***Project Debt - Other***

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

***Restricted Funds Held in Trust***

Restricted funds held in trust are primarily amounts received by third-party trustees relating to certain projects we own which may be used only for specified purposes. We generally do not control these accounts. They primarily include debt service reserves for payment of principal and interest on project debt, and deposits of revenues received with respect to projects prior to their disbursement, as provided in the relevant indenture or other agreements. Such funds are invested principally in money market funds, bank deposits and certificates of deposit, United States treasury bills and notes, and United States government agency securities. Restricted fund balances are as follows (in thousands):

	As of			
	March 31, 2011		December 31, 2010	
	Current	Noncurrent	Current	Noncurrent
Debt service funds - principal	\$ 38,733	\$ 72,446	\$ 84,569	\$ 72,396
Debt service funds - interest	7,229		5,769	
Total debt service funds	45,962	72,446	90,338	72,396
Revenue funds	24,844		17,522	
Other funds	25,941	35,134	17,708	35,028



Total	\$	96,747	\$	107,580	\$	125,568	\$	107,424
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Of the \$204.3 million in total restricted funds as of March 31, 2011, approximately \$111.2 million was designated for future payment of project debt principal.

**Capital Requirements**

Our projected contractual obligations are consistent with amounts disclosed in our Annual Report on Form 10-K for the year ended December 31, 2010. We believe that when combined with our other sources of liquidity, including our existing cash on hand and the Revolving Credit Facility, we will generate sufficient cash over at least the next twelve months to meet operational needs, make capital expenditures, invest in the business and service debt due.

**Table of Contents*****Other Commitments***

Other commitments as of March 31, 2011 were as follows (in thousands):

	<b>Commitments Expiring by Period</b>		
	<b>Total</b>	<b>Less Than One Year</b>	<b>More Than One Year</b>
Letters of credit	\$ 286,239	\$ 8,270	\$ 277,969
Surety bonds	85,889		85,889
Total other commitments net	\$ 372,128	\$ 8,270	\$ 363,858

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

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

The surety bonds listed on the table above relate primarily to performance obligations (\$74.8 million) and support for closure obligations of various energy projects when such projects cease operating (\$11.1 million). Were these bonds to be drawn upon, we would have a contractual obligation to indemnify the surety company.

We have certain contingent obligations related to the 7.25% Notes and the 3.25% Notes. These arise as follows:

- holders may require us to repurchase their 7.25% Notes and their 3.25% Notes if a fundamental change occurs; and
- holders may exercise their conversion rights upon the occurrence of certain events, which would require us to pay the conversion settlement amount in cash.

We have certain contingent obligations related to the Debentures. These arise as follows:

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

For specific criteria related to contingent interest, conversion or redemption features of the Debentures, refer to Note 12 of the Notes to Consolidated Financial Statements in our Form 10-K for the year ended December 31, 2010.

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

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**Recent Accounting Pronouncements**

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

**Discussion of Critical Accounting Policies and Estimates**

In preparing our condensed consolidated financial statements in accordance with United States generally accepted accounting principles, we are required to use judgment in making estimates and assumptions that affect the amounts reported in our financial statements and related Notes. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. These estimates form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Many of our critical accounting policies are subject to significant judgments and uncertainties which could potentially result in materially different results under different conditions and assumptions. Future events rarely develop exactly as forecast, and the best estimates routinely require adjustment. Management believes there have been no material changes during the three months ended March 31, 2011 to the items discussed in Discussion of Critical Accounting Policies in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations of our Annual Report on Form 10-K for the year ended December 31, 2010.

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

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

There have been no material changes during the three months ended March 31, 2011 to the items discussed in Item 7A. Quantitative and Qualitative Disclosures About Market Risk in our Annual Report on Form 10-K for the year ended December 31, 2010. For details related to fair value estimates for the Cash Conversion Option, Note Hedge and contingent interest as of March 31, 2011, refer to *Item 1. Financial Statements* Note 12. *Financial Instruments* and Note 13. *Derivative Instruments*.

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

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of Covanta's disclosure controls and procedures, as required by Rule 13a-15(b) and 15d-15(b) under the Securities Exchange Act of 1934 (the Exchange Act) as of March 31, 2011. Our disclosure controls and procedures are designed to reasonably assure that information required to be disclosed by us in reports we file or submit under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding disclosure and is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

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

Our management, including our Chief Executive Officer and Chief Financial Officer, believes that any disclosure controls and procedures or internal controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must consider the benefits of controls relative to their costs. Inherent limitations within a control

system include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by unauthorized override of the control. While the design of any system of controls is to provide reasonable assurance of the effectiveness of disclosure controls, such design is also based in part upon certain assumptions about the likelihood of future events, and such assumptions, while reasonable, may not take into account all potential future conditions. Accordingly, because of the inherent limitations in a cost effective control system, misstatements due to error or fraud may occur and may not be prevented or detected.

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**Changes in Internal Control over Financial Reporting**

There has not been any change in our system of internal control over financial reporting during the fiscal quarter ended March 31, 2011 that has materially affected, or is reasonably likely to materially affect, internal control over financial reporting.

**PART II OTHER INFORMATION**

**Item 1. LEGAL PROCEEDINGS**

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

**Item 1A. RISK FACTORS**

There have been no material changes during the three months ended March 31, 2011 to the risk factors discussed in Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2010.

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

None.

**Item 3. DEFAULTS UPON SENIOR SECURITIES**

None.

**Item 4. REMOVED AND RESERVED**

None

**Item 5. OTHER INFORMATION**

(a) None.

(b) Not applicable.

**Item 6. EXHIBITS**

<b>Exhibit Number</b>	<b>Description</b>
31.1	Certification pursuant to Section 302 of Sarbanes-Oxley Act of 2002 by the Chief Executive Officer.
31.2	Certification pursuant to Section 302 of Sarbanes-Oxley Act of 2002 by the Chief Financial Officer.
32	Certification of periodic financial report pursuant to Section 906 of Sarbanes-Oxley Act of 2002 by the Chief Executive Officer and Chief Financial Officer.
Exhibit 101.INS:	XBRL Instance Document*
Exhibit 101.SCH:	XBRL Taxonomy Extension Schema*

Exhibit 101.CAL: XBRL Taxonomy Extension Calculation Linkbase\*  
Exhibit 101.DEF: XBRL Taxonomy Extension Definition Document\*  
Exhibit 101.LAB: XBRL Taxonomy Extension Labels Linkbase\*  
Exhibit 101.PRE: XBRL Taxonomy Extension Presentation Linkbase\*

\* XBRL information is furnished, not filed.

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**SIGNATURES**

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

COVANTA HOLDING CORPORATION  
(Registrant)

By: */s/ Sanjiv Khattri*  
Sanjiv Khattri  
*Executive Vice President and Chief Financial Officer*

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

Date: April 20, 2011