COVANTA HOLDING CORP
Form 10-Q
October 22, 2008

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

**Form 10-Q**

| | |
|---|---|
| þ | **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**<br>**For the quarterly period ended September 30, 2008** |
| | **OR** |
| o | **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**<br>**For the transition period from to** |

**Commission file number 1-6732**

**Covanta Holding Corporation**
*(Exact name of registrant as specified in its charter)*

| | |
|---|---|
| **Delaware**<br>*(State or other jurisdiction of incorporation or organization)* | **95-6021257**<br>*(I.R.S. Employer Identification Number)* |
| **40 Lane Road, Fairfield, NJ**<br>*(Address of Principal Executive Office)* | **07004**<br>*(Zip code)* |

**(973) 882-9000**
*(Registrant s telephone number including area code)*

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

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

| | | | |
|---|---|---|---|
| Large accelerated filer þ | Accelerated filer o | Non-accelerated filer o<br>(Do not check if a smaller reporting company) | Smaller reporting company o |

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

**APPLICABLE ONLY TO CORPORATE ISSUERS:**

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

| Class | Outstanding at October 16, 2008 |
|---|---|
| Common Stock, $0.10 par value | 154,278,497 shares |

**COVANTA HOLDING CORPORATION AND SUBSIDIARIES**

**FORM 10-Q QUARTERLY REPORT**
**For the Quarter Ended September 30, 2008**


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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, 2007 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.

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## PART I. FINANCIAL INFORMATION

## ITEM 1. *FINANCIAL STATEMENTS*

### COVANTA HOLDING CORPORATION AND SUBSIDIARIES

### CONDENSED CONSOLIDATED STATEMENTS OF INCOME

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2008 | 2007 | 2008 | 2007 |
| | (Unaudited) (In thousands, except per share amounts) | | | |
| **OPERATING REVENUES:** | | | | |
| Waste and service revenues | $ 238,304 | $ 212,088 | $ 698,616 | $ 629,039 |
| Electricity and steam sales | 183,821 | 123,684 | 500,718 | 364,165 |
| Other operating revenues | 16,546 | 16,578 | 51,099 | 44,495 |
| Total operating revenues | 438,671 | 352,350 | 1,250,433 | 1,037,699 |
| **OPERATING EXPENSES:** | | | | |
| Plant operating expenses | 245,966 | 187,874 | 743,585 | 589,442 |
| Depreciation and amortization expense | 51,980 | 50,540 | 152,144 | 147,019 |
| Net interest expense on project debt | 13,745 | 12,501 | 41,282 | 40,992 |
| General and administrative expenses | 23,282 | 18,483 | 70,571 | 60,704 |
| Write-down of assets, net of insurance recoveries | | | | 4,925 |
| Other operating expenses | 15,615 | 11,325 | 47,474 | 37,498 |
| Total operating expenses | 350,588 | 280,723 | 1,055,056 | 880,580 |
| **Operating income** | 88,083 | 71,627 | 195,377 | 157,119 |
| **Other income (expense):** | | | | |
| Investment income | 1,520 | 1,963 | 4,212 | 8,966 |
| Interest expense | (10,593) | (16,018) | (35,876) | (51,996) |
| Loss on extinguishment of debt | | (65) | | (32,071) |
| Total other expenses | (9,073) | (14,120) | (31,664) | (75,101) |
| Income before income tax expense, minority interests and equity in net income from unconsolidated investments | 79,010 | 57,507 | 163,713 | 82,018 |
| Income tax expense | (31,687) | (23,768) | (65,483) | (34,414) |
| Minority interests | (3,166) | (2,055) | (7,260) | (5,544) |
| | 5,543 | 6,731 | 18,355 | 16,153 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Equity in net income from unconsolidated investments | | | | | | | | |
| **NET INCOME** | $ | 49,700 | $ | 38,415 | $ | 109,325 | $ | 58,213 |
| **Weighted Average Common Shares Outstanding:** | | | | | | | | |
| Basic | | 153,411 | | 153,035 | | 153,321 | | 152,504 |
| Diluted | | 154,833 | | 154,319 | | 154,751 | | 153,844 |
| **Earnings Per Share:** | | | | | | | | |
| Basic | $ | 0.32 | $ | 0.25 | $ | 0.71 | $ | 0.38 |
| Diluted | $ | 0.32 | $ | 0.25 | $ | 0.71 | $ | 0.38 |

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 | |
|---|---|---|
| | September 30, 2008 (Unaudited) | December 31, 2007 |
| | (In thousands, except per share amounts) | |
| **ASSETS** | | |
| **Current:** | | |
| Cash and cash equivalents | $ 169,003 | $ 149,406 |
| Marketable securities available for sale | 300 | 2,495 |
| Restricted funds held in trust | 283,795 | 187,951 |
| Receivables (less allowances of $3,633 and $4,353) | 263,393 | 252,114 |
| Unbilled service receivables | 54,667 | 59,232 |
| Deferred income taxes | 44,169 | 29,873 |
| Prepaid expenses and other current assets | 105,181 | 113,927 |
| **Total Current Assets** | 920,508 | 794,998 |
| Property, plant and equipment, net | 2,566,125 | 2,620,507 |
| Investments in fixed maturities at market (cost: $27,680 and $26,338) | 26,942 | 26,260 |
| Restricted funds held in trust | 196,593 | 191,913 |
| Unbilled service receivables | 47,761 | 56,685 |
| Waste, service and energy contracts, net | 234,874 | 268,353 |
| Other intangible assets, net | 84,590 | 88,954 |
| Goodwill | 80,986 | 127,027 |
| Investments in investees and joint ventures | 101,649 | 81,248 |
| Other assets | 127,210 | 112,554 |
| **Total Assets** | $ 4,387,238 | $ 4,368,499 |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | |
| **Current:** | | |
| Current portion of long-term debt | $ 6,718 | $ 6,898 |
| Current portion of project debt | 190,446 | 195,625 |
| Accounts payable | 31,069 | 29,916 |
| Deferred revenue | 25,456 | 25,114 |
| Accrued expenses and other current liabilities | 224,884 | 234,000 |
| **Total Current Liabilities** | 478,573 | 491,553 |
| Long-term debt | 1,007,668 | 1,012,534 |
| Project debt | 1,005,102 | 1,084,650 |
| Deferred income taxes | 453,364 | 440,723 |
| Waste and service contracts | 117,813 | 130,464 |

| | | |
|---|---|---|
| Other liabilities | 145,075 | 141,740 |
| **Total Liabilities** | 3,207,595 | 3,301,664 |
| **Commitments and Contingencies (Note 14)** | | |
| **Minority Interests** | 40,197 | 40,773 |
| **Stockholders Equity:** | | |
| 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 154,794 and 154,281 shares; outstanding 154,279 and 153,922 shares) | 15,479 | 15,428 |
| Additional paid-in capital | 773,165 | 765,287 |
| Accumulated other comprehensive income | 12,450 | 16,304 |
| Accumulated earnings | 338,404 | 229,079 |
| Treasury stock, at par | (52) | (36) |
| **Total Stockholders Equity** | 1,139,446 | 1,026,062 |
| **Total Liabilities and Stockholders Equity** | $ 4,387,238 | $ 4,368,499 |

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**

| | For the Nine Months Ended September 30, | |
|---|---|---|
| | 2008 | 2007 |
| | (Unaudited) (In thousands) | |
| **OPERATING ACTIVITIES:** | | |
| Net income | $ 109,325 | $ 58,213 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization expense | 152,144 | 147,019 |
| Write-down of assets, net of insurance recoveries | | 4,925 |
| Loss on extinguishment of debt | | 32,071 |
| Amortization of long-term debt deferred financing costs | 2,777 | 2,698 |
| Amortization of debt premium and discount | (8,282) | (10,687) |
| Stock-based compensation expense | 11,386 | 10,126 |
| Equity in net income from unconsolidated investments | (18,355) | (16,153) |
| Dividends from unconsolidated investments | 16,156 | 7,269 |
| Minority interests | 7,260 | 5,544 |
| Deferred income taxes | 43,225 | 14,941 |
| Other, net | 9,139 | 1,868 |
| Change in restricted funds held in trust | (58,774) | (15,573) |
| Change in working capital, net of effects of acquisitions | 1,497 | 2,063 |
| Net cash provided by operating activities | 267,498 | 244,324 |
| **INVESTING ACTIVITIES:** | | |
| Purchase of equity interests | (18,503) | (10,253) |
| Acquisition of businesses, net of cash acquired | (20,128) | (63,255) |
| Proceeds from the sale of investment securities | 20,175 | 13,015 |
| Purchase of investment securities | (18,662) | |
| Purchase of property, plant and equipment | (67,300) | (60,231) |
| Property insurance proceeds | 6,315 | 7,341 |
| Acquisition of land use rights | (16,004) | |
| Other, net | (4,149) | 2,310 |
| Net cash used in investing activities | (118,256) | (111,073) |
| **FINANCING ACTIVITIES:** | | |
| Proceeds from the issuance of common stock, net | | 135,757 |
| Proceeds from the exercise of options for common stock, net | 265 | 606 |
| Proceeds from borrowings on long-term debt | | 949,907 |
| Financings of insurance premiums, net | (8,062) | |
| Proceeds from borrowings on project debt | 4,105 | 3,426 |

| | | |
|---|---|---|
| Proceeds from borrowings on revolving credit facility | | 30,000 |
| Principal payments on long-term debt | (5,046) | (1,168,148) |
| Principal payments on project debt | (74,331) | (73,393) |
| Payments of borrowings on revolving credit facility | | (30,000) |
| Payments of long-term debt deferred financing costs | | (18,324) |
| Payments of tender premiums on debt extinguishment | | (33,016) |
| Decrease in holding company restricted funds | | 6,660 |
| Increase in restricted funds held in trust | (41,385) | (25,109) |
| Distributions to minority partners | (5,038) | (5,756) |
| Net cash used in financing activities | (129,492) | (227,390) |
| Effect of exchange rate changes on cash and cash equivalents | (153) | 375 |
| Net increase (decrease) in cash and cash equivalents | 19,597 | (93,764) |
| Cash and cash equivalents at beginning of period | 149,406 | 233,442 |
| Cash and cash equivalents at end of period | $ 169,003 | $ 139,678 |

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

## COVANTA HOLDING CORPORATION AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

### Note 1. Organization and Basis of Presentation

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

***Organization***

We are a leading developer, owner and operator of infrastructure for the conversion of waste to energy (known as energy-from-waste ), as well as other waste disposal and renewable energy production businesses in the Americas, Europe and Asia. We conduct all of our operations through subsidiaries which are engaged predominantly in the businesses of waste and energy services. We also engage in the independent power production business outside the Americas.

We own, have equity investments in, and/or operate 58 energy generation facilities, 48 of which are in the United States and 10 of which are located outside the United States. Our energy generation facilities use a variety of fuels, including municipal solid waste, wood waste (biomass), landfill gas, water (hydroelectric), natural gas, coal, and heavy fuel-oil. We also own or operate several businesses that are associated with our energy-from-waste business, including a waste procurement business, four landfills, and several waste transfer stations. We have two reportable segments, Domestic and International, which are comprised of our domestic and international waste and energy services operations, respectively.

***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. Operating results for the interim period are not necessarily indicative of the results that may be expected for the fiscal year ended December 31, 2008. 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, 2007 ( 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.

Certain prior period amounts have been reclassified in the unaudited condensed consolidated financial statements to conform to the current period presentation. All intercompany accounts and transactions have been eliminated.

During the first quarter of 2008, we revised our presentation of the condensed consolidated statements of cash flows to present changes in restricted funds held in trust relating to operating activities as a component of cash flow from operating activities and changes in restricted funds held in trust relating to financing activities (debt principal

repayments) as a component of cash flow from financing activities; previously we included all changes in restricted funds held in trust as a component of cash flow from financing activities. For the nine months ended September 30, 2007, we have reclassified approximately $15.6 million as a component of cash flow from operating activities in order to conform to the current period presentation on the condensed consolidated statements of cash flows.

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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES**

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

**Note 2. Recent Accounting Pronouncements**

In May 2008, the Financial Accounting Standards Board ( FASB ) issued FASB Staff Position ( FSP ) No. APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement) ( FSP APB 14-1 ). The FSP requires the issuer of convertible debt instruments with cash settlement features to separately account for the liability and equity components of the instrument. The debt component should be recognized at the present value of its cash flows discounted using the issuer s nonconvertible debt borrowing rate. The equity component should be recognized as the difference between the proceeds from the issuance of the note and the fair value of the liability, net of deferred taxes. FSP APB 14-1 also requires an accretion of the resultant debt discount over the expected life of the debt. FSP APB 14-1, effective for us on January 1, 2009 for our convertible debentures, requires retrospective application for all periods presented, and does not grandfather existing instruments. We estimate that the pre-tax increase in non-cash interest expense to be recognized on our condensed consolidated financial statements using a 7.25% discount rate, our nonconvertible debt borrowing rate at the date of the bond s issuance, would be as follows (in millions):

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012-2027 | Total |
|---|---|---|---|---|---|---|---|
| Pre-tax increase in non-cash interest expense | $ 5.2 | $ 6.1 | $ 6.5 | $ 7.0 | $ 7.6 | $ 213.9 | $ 246.3 |

In March 2008, the FASB issued Statement of Financial Accounting Standards ( SFAS ) No. 161, Disclosures about Derivative Instruments and Hedging Activities ( SFAS 161 ), which is intended to improve financial reporting about derivative instruments and hedging activities by requiring enhanced disclosures to enable investors to better understand the effects on an entity s financial position, financial performance, and cash flows. SFAS 161 is effective for us on January 1, 2009. Although we do not currently expect the adoption of SFAS 161 to result in additional financial reporting disclosures, we are continuing to assess the potential disclosure effects of SFAS 161.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements ( SFAS 160 ). SFAS 160 amends Accounting Research Bulletin No. 51, Consolidated Financial Statements, to establish accounting and reporting for the noncontrolling (minority) interests in a subsidiary and the deconsolidation of a subsidiary. Moreover, SFAS 160 eliminates the diversity that currently exists in accounting for transactions between an entity and noncontrolling interests by requiring they be treated as equity transactions. SFAS 160 is effective for us on January 1, 2009. Although we do not currently expect the adoption of SFAS 160 to have a material impact on our consolidated financial statements, we are continuing to assess the potential effects of SFAS 160.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), Business Combinations ( SFAS 141(R) ). SFAS 141(R) establishes principles and requirements for the acquiring entity in a business combination to: recognize and measure the assets acquired and liabilities assumed in the transaction including any noncontrolling interest of the acquired entity; recognize and measure any goodwill acquired or gain resulting from a bargain purchase; establish the acquisition-date fair value as the measurement objective; and disclose to investors and other users of financial statements all of the information they need to evaluate and understand the nature and financial effect of the business combination. Other significant changes include: expensing of direct transaction costs as incurred; capitalizing in-process research and development costs; and recording a liability for contingent consideration at the measurement

date with subsequent remeasurement recognized in the results of operations. SFAS 141(R) also requires that any costs for business restructuring and exit activities related to the acquired company will be included in the post-combination results of operations. SFAS 141(R) is effective for us on January 1, 2009. Although we do not currently expect the adoption of SFAS 141(R) to have a material impact on our consolidated financial statements, we are continuing to assess the potential effects of SFAS 141(R).

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COVANTA HOLDING CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB Statement No. 115 ( SFAS 159 ). SFAS 159 allows entities to voluntarily choose to measure certain financial assets and liabilities at fair value ( fair value option ). The fair value option may be elected on an instrument-by-instrument basis and is irrevocable, unless a new election date occurs. If the fair value option is elected for an instrument, SFAS 159 specifies that the effect of the first remeasurement to fair value will be reported as a cumulative-effect adjustment to the opening balance of retained earnings and unrealized gains and losses for that instrument shall be reported in earnings at each subsequent reporting date. We adopted SFAS 159 on January 1, 2008, but did not elect to apply the fair value option to any of our eligible financial assets and liabilities.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements ( SFAS 157 ), which defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements. This statement does not require any new fair value measurements. SFAS 157 was effective for us on January 1, 2008. In February 2008, the FASB issued FASB Staff Position FAS 157-2, Effective Date of FASB Statement No. 157, which deferred the effective date of SFAS 157 for one year for all non-financial assets and non-financial liabilities, except for those items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The partial adoption of SFAS 157 on January 1, 2008 had no impact on our financial position, results of operations, cash flows or earnings per share. Our investment securities that are traded on a national securities exchange are stated at the last reported sales price on the day of valuation; other securities in the over-the-counter market and listed securities for which no sale was reported on the date are stated at the last quoted bid price.

| | As of September 30, 2008 | Fair Value Measurements at Reporting Date Using Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| | | (In thousands) | | |
| Marketable securities available for sale | $ 300 | $ 300 | $ | $ |
| Investments in fixed maturities at market | 26,942 | 26,942 | | |
| Derivatives Contingent interest feature of the Convertible Debentures (See Note 12) | 0 | | 0 | |
| Total | $ 27,242 | $ 27,242 | $ 0 | $ |

**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, as well as 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. Acquisitions are accounted for under the purchase method of accounting. 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 unaudited condensed consolidated financial statements individually or in the aggregate and therefore, disclosures of pro forma financial information have not been presented.

**COVANTA HOLDING CORPORATION AND SUBSIDIARIES**

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

***Domestic***

*Pasco County, Florida Energy-from-Waste Facility*

On September 23, 2008, we entered into a new service fee type contract with the Pasco County Commission in Florida which commences on January 1, 2009 and extends the existing contract from 2011 to 2016.

*Indianapolis Energy-from-Waste Facility*

On July 25, 2008, we entered into a new tip fee type contract with the City of Indianapolis for a term of 10 years commencing upon expiration of the existing service fee type contract in December 2008.

*Alternative Energy Technology Development*

We have entered into various agreements with multiple partners for the development, testing or licensing of new technologies related to the transformation of waste materials into renewable fuels or the generation of energy. Initial licensing fees and demonstration unit purchases approximated $4.3 million during the quarter ended September 30, 2008.

*Tulsa Energy-from-Waste Facility*

On June 2, 2008, we acquired an energy-from-waste facility in Tulsa, Oklahoma from The CIT Group/Equipment Financing, Inc. for cash consideration of approximately $12.7 million. The design capacity of the facility is 1,125 tons per day ( tpd ) of waste and gross electric capacity of 16.5 megawatts ( MW ). This facility was shut down by the prior owner in the summer of 2007 and we are planning to return two of the facility s three boilers to service before the end of 2008, and return its third boiler to service during 2009. During the nine months ended September 30, 2008, we have invested approximately $2.3 million in capital improvements to restore the operational performance of the facility.

*Peabody Landfill*

On May 20, 2008, we acquired a landfill for the disposal of ash in Peabody, Massachusetts from Peabody Monofill Associates, Inc. and others for cash consideration of approximately $7.4 million.

*Harrisburg Energy-from-Waste Facility*

In February 2008, we entered into a ten year agreement to maintain and operate an 800 tpd energy-from-waste facility located in Harrisburg, Pennsylvania. Under the agreement, we have a right of first refusal to purchase the facility. We also have agreed to provide construction management services and to advance up to $25.5 million in funding for certain facility improvements required to enhance facility performance, the repayment of which is guaranteed by the City of Harrisburg. As of September 30, 2008, we have advanced $2.4 million under this funding arrangement. The facility improvements are expected to be completed by mid 2009.

*Massachusetts Energy-from-Waste Facilities and Transfer Stations*

On October 1, 2007, we acquired the operating businesses of EnergyAnswers Corporation for cash consideration of approximately $41 million. We also assumed net debt of $21 million ($23 million of consolidated indebtedness net of $2 million of restricted funds held in trust). These businesses include a 400 tpd energy-from-waste facility in Springfield, Massachusetts and a 240 tpd energy-from-waste facility in Pittsfield, Massachusetts. Approximately 75% of waste revenues are contracted for at these facilities. We subsequently sold certain assets acquired in this transaction for a total consideration of $5.8 million during the fourth quarter of 2007 and the first quarter of 2008. The purchase price allocation included $9.8 million of goodwill.

*Westchester Transfer Stations*

On October 1, 2007, we acquired two waste transfer stations in Westchester County, New York from Regus Industries, LLC for cash consideration of approximately $7.3 million.

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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES**

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

*Biomass Energy Facilities*

On July 16, 2007, we acquired Central Valley Biomass Holdings, LLC ( Central Valley ) from The AES Corporation. Under the terms of the purchase agreement, we paid $51 million in cash plus approximately $5 million in cash related to post-closing adjustments and transaction costs. Central Valley owns two biomass energy facilities and a biomass energy fuel management business, which are all located in California. In addition, we invested approximately $8 million prior to December 31, 2007 and approximately $11 million during the nine months ended September 30, 2008 in capital improvements to significantly increase the facilities productivity and improve environmental performance. As of September 30, 2008, these capital improvements have been completed. The purchase price allocation included $23.6 million of goodwill.

*Holliston Transfer Station*

On April 30, 2007, we acquired a waste transfer station in Holliston, Massachusetts from Casella Waste Systems Inc. for cash consideration of approximately $7.5 million. In addition, we invested approximately $4.2 million prior to December 31, 2007 and approximately $1 million during the nine months ended September 30, 2008 in capital improvements to enhance the environmental and operational performance of the transfer station.

*Lee County Energy-from-Waste Facility*

In December 2007, we completed the expansion and commenced the operation of the expanded energy-from-waste facility located in and owned by Lee County in Florida. We expanded waste processing capacity from 1,200 tpd to 1,836 tpd and increased gross electricity capacity from 36.9 MW to 57.3 MW. As part of the agreement to implement this expansion, we received a long-term operating contract extension expiring in 2024.

*Hillsborough County Energy-from-Waste Facility*

We designed, constructed, and now operate and maintain the 1,200 tpd mass-burn energy-from-waste facility located in and owned by Hillsborough County in Florida. Due to the growth in the amount of municipal solid waste generated in Hillsborough County, Hillsborough County informed us of its desire to expand the facility s waste processing and electricity generation capacities. In August 2005, we entered into agreements with Hillsborough County to implement this expansion, and to extend the agreement under which we operate the facility through 2027. Environmental and other project related permits have been secured and the expansion construction commenced on December 29, 2006. Completion of the expansion, and commencement of the operation of the expanded project, is expected in 2009.

***International***

*China*

On April 2, 2008, our project joint venture with Chongqing Iron & Steel Company (Group) Limited received an award to build, own, and operate an 1,800 tpd energy-from-waste facility for Chengdu Municipality, in Sichuan Province, Peoples Republic of China. On June 25, 2008, the project s 25 year waste concession agreement was executed. In connection with this project, we invested $17.1 million for a 49% equity interest in the project joint venture. The Chengdu project is expected to commence construction in late 2008 or early 2009, and commence operations in 2011.

In December 2007, we entered into a joint venture with Guangzhou Development Power Investment Co., Ltd. through which we intend to develop energy-from-waste projects in Guangdong Province, Peoples Republic of China. We hold a 40% equity interest in the joint venture entity, Guangzhou Development Covanta Environmental Energy Co., Ltd ( GDC Environmental Energy ), and on June 6, 2008, we invested $1.5 million in the joint venture.

On April 25, 2007, we purchased a 40% equity interest in Chongqing Sanfeng Environmental Industry Co., Ltd. ( Sanfeng ), a company located in Chongqing Municipality, Peoples Republic of China. The company, which was renamed Sanfeng Covanta Environmental Industry Co., Ltd., owns minority equity interests in two 1,200 metric tpd 24 MW mass-burn energy-from-waste projects. We made an initial cash payment of approximately $10 million in connection with our investment in Sanfeng.

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## COVANTA HOLDING CORPORATION AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

*Ireland*

On September 6, 2007, we entered into definitive agreements to build, own, and operate a 1,700 metric tpd energy-from-waste project serving the City of Dublin, Ireland and surrounding communities. The Dublin project is being developed and will be owned by Dublin Waste to Energy Limited, which is co-owned by us and DONG Energy Generation A/S. As part of the transaction, we purchased a controlling stake in Dublin Waste to Energy Limited. Project construction, which is expected to start in late 2008 or early 2009, is estimated to cost approximately 300 million euros and is expected to require 36 months to complete. Dublin Waste to Energy Limited has a 25-year tip fee type contract to provide disposal service for approximately 320,000 metric tons of waste annually. The project is expected to sell electricity into the local electricity grid under short-term arrangements. We and DONG Energy Generation A/S have committed to provide financing for all phases of the project, and we expect to arrange for project financing.

**Note 4. Earnings Per Share**

Per share data is based on the weighted average outstanding number of our, par value $0.10 per share, common stock during the relevant period. Basic earnings per share are calculated using 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, and rights whether or not currently exercisable. Diluted earnings per share for all the periods presented does not include securities if their effect was antidilutive (in thousands, except per share amounts).

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2008 | 2007 | 2008 | 2007 |
| Net income | $ 49,700 | $ 38,415 | $ 109,325 | $ 58,213 |
| **Basic earnings per share:** | | | | |
| Weighted average basic common shares outstanding | 153,411 | 153,035 | 153,321 | 152,504 |
| Basic earnings per share | $ 0.32 | $ 0.25 | $ 0.71 | $ 0.38 |
| **Diluted earnings per share:** | | | | |
| Weighted average basic common shares outstanding | 153,411 | 153,035 | 153,321 | 152,504 |
| Dilutive effect of stock options | 696 | 592 | 687 | 621 |
| Dilutive effect of restricted stock | 726 | 692 | 743 | 719 |
| Dilutive effect of convertible debentures | | | | |
| Weighted average diluted common shares outstanding | 154,833 | 154,319 | 154,751 | 153,844 |
| Diluted earnings per share | $ 0.32 | $ 0.25 | $ 0.71 | $ 0.38 |

| | | | | |
|---|---|---|---|---|
| Stock options excluded from the weighted average dilutive common shares outstanding because their inclusion would have been antidilutive | 300 | 1,755 | 300 | 1,755 |
| Restricted stock awards excluded from the weighted average dilutive common shares outstanding because their inclusion would have been antidilutive | | | | |

On September 22, 2008, we announced that our Board of Directors authorized the purchase of up to $30 million of our common stock in order to respond opportunistically to volatile market conditions. The share repurchases, if any, may take place from time to time based on market conditions and other factors. The authorization is expected to continue only for so long as recent volatile market conditions persist. During the three and nine months ended September 30, 2008, we did not repurchase shares of our common stock.

**COVANTA HOLDING CORPORATION AND SUBSIDIARIES**

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

On January 31, 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. As of September 30, 2008, the Debentures did not have a dilutive effect on earnings per share.

**Note 5. Financial Information by Business Segments**

We have two reportable segments, Domestic and International, which are comprised of our domestic and international waste and energy services operations, respectively. The results of our reportable segments are as follows (in thousands):

| | Reportable Segments | | | |
|---|---|---|---|---|
| | Domestic | International | All Other(1) | Total |
| **Three Months Ended September 30, 2008:** | | | | |
| Operating revenues | $ 354,948 | $ 80,107 | $ 3,616 | $ 438,671 |
| Operating income | 83,701 | 4,211 | 171 | 88,083 |
| **Three Months Ended September 30, 2007:** | | | | |
| Operating revenues | $ 312,391 | $ 37,400 | $ 2,559 | $ 352,350 |
| Operating income (loss) | 66,182 | 5,840 | (395) | 71,627 |
| **Nine Months Ended September 30, 2008:** | | | | |
| Operating revenues | $ 1,028,961 | $ 212,038 | $ 9,434 | $ 1,250,433 |
| Operating income (loss) | 182,608 | 13,555 | (786) | 195,377 |
| **Nine Months Ended September 30, 2007:** | | | | |
| Operating revenues | $ 900,750 | $ 129,209 | $ 7,740 | $ 1,037,699 |
| Operating income (loss) | 144,497 | 14,163 | (1,541) | 157,119 |

(1) All other is comprised of our insurance subsidiaries operations.

**Note 6. Changes in Capitalization**

***Long-Term Debt***

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

| | As of | |
|---|---|---|
| | September 30, 2008 | December 31, 2007 |
| 1.00% Senior Convertible Debentures due 2027 | $ 373,750 | $ 373,750 |

| | | |
|---|---|---|
| Term loan due 2014 | 640,250 | 645,125 |
| Other long-term debt | 386 | 557 |
| Total | 1,014,386 | 1,019,432 |
| Less: current portion | (6,718) | (6,898) |
| Total long-term debt | $ 1,007,668 | $ 1,012,534 |

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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES**

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

***Short-Term Liquidity***

As of September 30, 2008, we had available credit for liquidity as follows (in thousands):

| | Total Available Under Facility | Maturing | Outstanding Letters of Credit as of September 30, 2008 | Available as of September 30, 2008 |
|---|---|---|---|---|
| Revolving Loan Facility(1) | $ 300,000 | 2013 | $ | $ 300,000 |
| Funded L/C Facility | $ 320,000 | 2014 | $ 310,347 | $ 9,653 |

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

Under our Revolving Loan Facility, we have pro rata funding commitments from a large consortium of banks, including a 6.8% pro rata commitment from Lehman Brothers Commercial Bank. Lehman Brothers Commercial Bank is a subsidiary of Lehman Brothers Holdings, Inc., which filed for bankruptcy protection in September 2008. We believe that neither the Lehman Brothers Holdings, Inc. bankruptcy, nor the ability of Lehman Brothers Commercial Bank (which is not currently part of such bankruptcy proceeding) to fund its pro rata share of any draw request we may make, will have a material affect on our liquidity.

***2007 Recapitalization***

During the first quarter of 2007, we completed a comprehensive recapitalization utilizing a series of equity and debt financings including the following transactions:

- the refinancing of our previously existing credit facilities with new credit facilities, comprised of a $300 million revolving credit facility (the Revolving Loan 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 );

- an underwritten public offering of 6.118 million shares of our common stock, from which we received proceeds of approximately $136.6 million, net of underwriting discounts and commissions;

- an underwritten public offering of approximately $373.8 million aggregate principal amount of Debentures, from which we received proceeds of approximately $364.4 million, net of underwriting discounts and commissions; and

the repayment, by means of a tender offer and redemptions, of approximately $611.9 million in aggregate principal amount of outstanding notes previously issued by certain of our intermediate subsidiaries. We completed our tender offer and redemptions for approximately $604.4 million in aggregate principal amount of outstanding notes on February 22, 2007. The remaining $7.5 million of the outstanding notes were redeemed in April 2007 and September 2007.

As a result of the recapitalization, we recognized a loss on extinguishment of debt of approximately $32.1 million, pre-tax, which was comprised of the write-down of deferred financing costs, tender premiums paid for the intermediate subsidiary debt, and a call premium paid in connection with previously existing financing arrangements. These amounts were partially offset by the write-down of unamortized premiums relating to the intermediate subsidiary debt and a gain associated with the settlement of our interest rate swap agreements.

***Credit Facilities***

The loan documentation under the Credit Facilities contains customary affirmative and negative covenants and financial covenants. We were in compliance with all required covenants as of September 30, 2008.

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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES**

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

***Stockholders Equity***

During the nine months ended September 30, 2008, we awarded grants for 493,573 shares of restricted stock awards and for 250,000 options to purchase shares of our common stock. See Note 11. Stock-Based Compensation.

**Note 7. Comprehensive Income**

The components of comprehensive income are as follows (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | **2008** | **2007** | **2008** | **2007** |
| Comprehensive income, net of income taxes: | | | | |
| Net income | $ 49,700 | $ 38,415 | $ 109,325 | $ 58,213 |
| Foreign currency translation | (1,098) | (2) | (2,352) | 2,631 |
| SFAS 158 unrecognized net loss | (169) | 26 | (508) | 79 |
| Net unrealized (gain) loss on available-for-sale securities | (622) | 332 | (994) | 569 |
| Net realized gain on derivative instruments | | | | (2,125) |
| Net comprehensive (loss) income adjustments | (1,889) | 356 | (3,854) | 1,154 |
| Comprehensive income | $ 47,811 | $ 38,771 | $ 105,471 | $ 59,367 |

**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 subsidiary, Covanta Lake II, Inc. files outside of the consolidated return group. 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, including discrete items, for the year ended December 31, 2008 to be approximately 40%. We review the annual effective tax rate on a quarterly basis as projections are revised. The effective income tax rate was 40% and 42% for the nine months ended September 30, 2008 and 2007, respectively. The liability for uncertain tax positions, exclusive of interest and penalties, was $26.7 million and $25.4 million as of September 30, 2008 and December 31, 2007, respectively. No material additional liabilities were recorded for uncertain tax positions during the nine months ended September 30, 2008. Included in the balance of unrecognized tax benefits as of September 30, 2008 are potential benefits of $3.4 million that, if recognized, would impact the effective tax rate.

We continue to reflect interest accrued on uncertain tax positions and penalties as part of the tax provision under FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement

No. 109, ( FIN 48 ). For the three months ended September 30, 2008 and 2007, we recognized $0.3 million and $0.2 million, respectively and for the nine months ended September 30, 2008 and 2007, we recognized $1.0 million and $0.7 million, respectively of interest and penalties on uncertain tax positions. As of September 30, 2008 and December 31, 2007, we had accrued interest and penalties associated with unrecognized tax benefits of $9.1 million and $7.6 million, respectively.

As issues are examined by the Internal Revenue Service ( IRS ) and state auditors, we may decide to adjust the existing FIN 48 liability for issues that were not deemed an exposure at the time we adopted FIN 48. Accordingly, we will continue to monitor the results of these audits and adjust the liability as needed. Federal income tax returns for our subsidiary Covanta Energy are closed for the years through 2004. However, to the extent net operating loss carryforwards ( NOLs ) are utilized from earlier years, this will allow the IRS to re-examine closed years. The tax returns of our subsidiary Covanta ARC Holdings, Inc. and its subsidiaries ( ARC Holdings ) are open for federal

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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES**

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

audit for the tax return years of 2001 and forward, and are currently the subject of an IRS examination. This examination is related to ARC Holdings refund requests related to NOL carryback claims from tax years prior to our acquisition of ARC Holdings in 2005 that require Joint Committee approval. 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, which was formerly named Mission Insurance Group, Inc., Mission ). Some of these Mission insurance entities have been in state insolvency proceedings in California and Missouri since the late 1980 s. In connection with the continued administration of the trust estates and implementation of arrangements with us, the California Commissioner has received court approvals that we expect will result in additional tax deductions or NOLs becoming available to us.

During the quarter ended September 30, 2008, a deferred tax asset of $46.9 million was recognized on our consolidated balance sheet as a result of revised taxable losses from the California grantor trusts for the 2004 tax year. These increases were recorded as a reduction to goodwill associated with the ARC Holdings acquisition, since the facts and circumstances associated with these items existed as of the date of the ARC Holdings acquisition, and if not for the ARC Holdings acquisition we would not have been able to make the conclusion that it was more likely than not that these deferred tax assets would be realized.

While we cannot predict with certainty what amounts, if any, may be includable in taxable income as a result of the final administration of the Missouri grantor trusts, we believe that the final administration by the Missouri Director of Insurance will not result in a material reduction in available NOLs.

We had consolidated federal NOLs estimated to be approximately $290 million for federal income tax purposes as of December 31, 2007, based on the tax returns as filed. The NOLs will expire in various amounts from December 31, 2009 through December 31, 2026, if not used. In addition to the consolidated federal NOLs, as of December 31, 2007, we had additional federal credit carryforwards of $21.6 million based on the final tax returns as filed, federal loss carryforwards of $85.0 million and state NOL carryforwards of $232.4 million, all of which will expire between 2008 and 2026. These deferred tax assets are offset by a valuation allowance of $33.2 million.

For further information, refer to Note 9. Income Taxes of the Notes to the Consolidated Financial Statements included in our Form 10-K.

**Note 9. Supplementary Information**

***Operating Revenues***

The components of waste and service revenues are as follows (in thousands):

| | For the Three Months Ended September 30, | For the Nine Months Ended September 30, |
|---|---|---|

| | 2008 | 2007 | 2008 | 2007 |
|---|---|---|---|---|
| Waste and service revenues unrelated to project debt | $ 214,314 | $ 187,115 | $ 627,143 | $ 553,687 |
| Revenue earned explicitly to service project debt-principal | 17,166 | 17,290 | 51,530 | 51,871 |
| Revenue earned explicitly to service project debt-interest | 6,824 | 7,683 | 19,943 | 23,481 |
| Total waste and service revenues | $ 238,304 | $ 212,088 | $ 698,616 | $ 629,039 |

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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES**

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

Under some of our service agreements, we bill municipalities fees to service project debt (principal and interest). The amounts billed are based on the actual principal amortization schedule for the project bonds. Regardless of the amounts billed to client communities relating to project debt principal, we recognize revenue earned explicitly to service project debt principal on a levelized basis over the term of the applicable agreement. In the beginning of the agreement, principal billed is less than the amount of levelized revenue recognized related to principal and we record an unbilled service receivable asset. At some point during the agreement, the amount we bill will exceed the levelized revenue and the unbilled service receivable begins to reduce, and ultimately becomes nil at the end of the contract.

In the final year(s) of a contract, cash is utilized from debt service reserve accounts to pay remaining principal amounts due to project bondholders and such amounts are no longer billed to or paid by municipalities. Generally, therefore, in the last year of the applicable agreement, little or no cash is received from municipalities relating to project debt, while our levelized service revenue continues to be recognized until the expiration date of the term of the agreement.

Our independent power production facilities in India generate electricity and steam explicitly for specific purchasers and as such, these agreements are considered lease arrangements. Electricity and steam sales included lease income from our international business of $69.4 million and $28.0 million for the three months ended September 30, 2008 and 2007, respectively, and $182.5 million and $100.3 million for the nine months ended September 30, 2008 and 2007, respectively.

***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 $17.2 million and $13.5 million for the three months ended September 30, 2008 and 2007, respectively, and $48.9 million and $43.0 million for the nine months ended September 30, 2008 and 2007, respectively.

*Amortization of waste, service and energy contracts*

The vast majority of our waste, service and energy contracts were valued in March 2004 and June 2005 related to the acquisitions of Covanta Energy and ARC Holdings, respectively. These intangible assets and liabilities were recorded using then-available information at their estimated fair market values based upon discounted cash flows. The following table details the amount of the actual/estimated amortization expense and contra-expense associated with these intangible assets and liabilities as of September 30, 2008 included or expected to be included in our statement of income for each of the years indicated (in thousands):

| | **Waste, Service and Energy Contracts** | **Waste and Service Contracts (Contra-Expense)** |
|---|---|---|

| | | (Amortization Expense) |
|---|---|---|
| Nine Months ended September 30, 2008 | $ 34,240 | $ (9,781) |
| Remainder of 2008 | $ 11,536 | $ (3,280) |
| 2009 | 42,302 | (13,178) |
| 2010 | 29,864 | (12,721) |
| 2011 | 26,740 | (12,408) |
| 2012 | 24,647 | (12,413) |
| Thereafter | 99,785 | (63,813) |
| Total | $ 234,874 | $ (117,813) |

**COVANTA HOLDING CORPORATION AND SUBSIDIARIES**

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

*SEMASS Fire*

On March 31, 2007, our SEMASS energy-from-waste facility located in Rochester, Massachusetts experienced a fire in the front-end receiving portion of the facility. Damage was extensive to this portion of the facility and operations at the facility were suspended completely for approximately 20 days. As a result of this loss, we recorded an asset impairment of $18.3 million, pre-tax, in the first quarter of 2007, which represented a preliminary estimate of the net book value of the damaged assets. During the year ended December 31, 2007, we reduced the impairment recorded by $1.0 million, pre-tax, based upon additional analysis as the facility was being restored.

The cost of repair or replacement, and business interruption losses, are insured under the terms of applicable insurance policies, subject to deductibles. During the second quarter of 2008 we received cash proceeds of $7.2 million in settlement of our business interruption claim. Insurance recoveries are recorded as a reduction to the loss related to the write-down of assets where such recoveries relate to repair and reconstruction costs, or as a reduction to plant operating expenses where such recoveries relate to other costs or business interruption losses. We recorded insurance recoveries in our condensed consolidated statements of income as follows (in millions):

| | For the Nine Months Ended September 30, | |
|---|---|---|
| | 2008 | 2007 |
| Repair and reconstruction (reduction to Write-down of assets) | $ | $ 13.3 |
| Clean-up costs (reduction to Plant operating expenses) | $ | $ 2.7 |
| Business interruption losses (reduction to Plant operating expenses) | $ 5.2 | $ 2.0 |

During the fourth quarter of 2007, we recorded additional insurance recoveries of $4.0 million related to repair and reconstruction.

*Other operating expenses*

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

| | Other Operating Expenses | | | |
|---|---|---|---|---|
| | For the Three Months Ended September 30, | | For the Nine Months Ended September 30, | |
| | 2008 | 2007 | 2008 | 2007 |
| Construction costs | $ 11,340 | $ 12,534 | $ 36,607 | $ 34,365 |
| Insurance subsidiary operating expenses | 2,800 | 2,119 | 8,588 | 6,759 |
| Insurance recoveries | (487) | (1,359) | (4,256) | (1,437) |
| Foreign exchange loss (gain) | 874 | (232) | 870 | (1,304) |
| Other | 1,088 | (1,737) | 5,665 | (885) |

| | | | | |
|---|---|---|---|---|
| Total other operating expenses | $ 15,615 | $ 11,325 | $ 47,474 | $ 37,498 |

***Goodwill***

The following table details the changes in carrying value of goodwill for the nine months ended September 30, 2008 (in thousands):

| | **Total** |
|---|---|
| Balance as of December 31, 2007 | $ 127,027 |
| Decrease due to net deferred tax assets related to Grantor Trust items (Note 8) | (46,850) |
| Purchase price adjustment related to the Central Valley acquisition | 736 |
| Purchase price adjustment related to the EnergyAnswers acquisition | 73 |
| Balance as of September 30, 2008 | $ 80,986 |

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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES**

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

**Note 10. Benefit Obligations**

***Pension and Other Benefit Obligations***

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

| | Pension Benefits | | | | Other Post-Retirement Benefits | | | |
|---|---|---|---|---|---|---|---|---|
| | For the Three Months Ended September 30, | | For the Nine Months Ended September 30, | | For the Three Months Ended September 30, | | For the Nine Months Ended September 30, | |
| | 2008 | 2007 | 2008 | 2007 | 2008 | 2007 | 2008 | 2007 |
| Service cost | $ | $ | $ | $ | $ | $ | $ | $ |
| Interest cost | 1,176 | 1,146 | 3,528 | 3,437 | 137 | 192 | 411 | 576 |
| Expected return on plan assets | (1,182) | (1,108) | (3,546) | (3,323) | | | | |
| Amortization of actuarial (gain) loss | (131) | | (393) | | (38) | 26 | (115) | 79 |
| Net periodic benefit cost | $ (137) | $ 38 | $ (411) | $ 114 | $ 99 | $ 218 | $ 296 | $ 655 |

***Defined Contribution Plans***

Substantially all of our domestic employees are eligible to participate in defined contribution plans we sponsor. Our costs related to defined contribution plans were $3.1 million and $2.9 million for the three months ended September 30, 2008 and 2007, respectively and $10.0 million and $9.4 million for the nine months ended September 30, 2008 and 2007, respectively.

**Note 11. Stock-Based Compensation**

Compensation expense related to our stock-based payment awards totaled $3.3 million and $11.4 million during the three and nine months ended September 30, 2008, respectively, and $3.7 million and $10.1 million during the three and nine months ended September 30, 2007, respectively.

During the nine months ended September 30, 2008, we awarded certain employees 453,073 shares of restricted stock awards. The restricted stock awards will be expensed over the requisite service period, subject to an assumed ten percent forfeiture rate. The terms of the restricted stock awards include two vesting provisions; one based on a performance factor and continued service (applicable to 66% of the award) and one based solely on continued service (applicable to 34% of the award). If all performance and service criteria are satisfied, the awards vest during March of 2009, 2010 and 2011.

On May 1, 2008, in accordance with our existing program for annual director compensation, we awarded 40,500 shares of restricted stock under the Directors Plan. We determined that the service vesting condition of the restricted stock awards granted to the directors on May 1, 2008 to be non-substantive and, in accordance with SFAS No. 123 (revised 2004), *Share-Based Payments*, recorded the entire fair value of the award as compensation expense on the grant date.



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COVANTA HOLDING CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

On February 21, 2008 and March 31, 2008, we granted options to purchase an aggregate of 200,000 shares and 50,000 shares, respectively, of common stock. The options expire 10 years from the date of grant and vest in equal installments over five years commencing on March 17, 2009. The stock option fair values were estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

| Grant Date | Exercise Price | Risk-Free Interest Rate | Dividend Yield | Volatility Expected | Expected Life |
|---|---|---|---|---|---|
| February 21, 2008 | $ 26.26 | 3.387% | 0% | 28% | 6.54 years |
| March 31, 2008 | $ 27.50 | 2.977% | 0% | 31% | 6.48 years |

As of September 30, 2008, we had approximately $12.7 million and $7.6 million of unrecognized compensation expense related to our unvested restricted stock awards and unvested stock options, respectively. We expect this compensation expense to be recognized over a weighted average period of 1.8 years for our unvested restricted stock awards and 3.6 years for our unvested stock options.

**Note 12. Financial Instruments**

***Interest Rate Swaps***

Under financing arrangements in effect from June 24, 2005 to February 9, 2007, we were required to enter into hedging arrangements with respect to a portion of our exposure to interest rate changes with respect to our borrowing under the credit facilities which were in effect. These interest rate swaps were designated as cash flow hedges in accordance with SFAS No. 133 Accounting for Derivative Instruments and Hedging Activities. Accordingly, unrealized gains or losses were deferred in other comprehensive income until the hedged cash flows affect earnings. In connection with the refinancing of our debt facilities in January 2007, the interest rate swap agreements described above were settled on February 9, 2007 for a pre-tax gain of $3.4 million and we were no longer required to enter into interest rate swap agreements.

***Contingent Interest***

On January 31, 2007, we completed an underwritten public offering of $373.8 million aggregate principal amount of Senior Convertible Debentures. The Debentures bear interest at a rate of 1.00% per year, payable semi-annually in arrears, on February 1 and August 1 of each year, commencing on August 1, 2007, and will mature on February 1, 2027. Beginning with the six-month interest period commencing February 1, 2012, we will pay contingent interest on the Debentures during any six-month interest period in which the trading price of the Debentures measured over a specified number of trading days is 120% or more of the principal amount of the Debentures. When applicable, the contingent interest payable per $1,000 principal amount of Debentures will equal 0.25% of the average trading price of $1,000 principal amount of Debentures during the five trading days ending on the second trading day immediately preceding the first day of the applicable six-month interest period. The contingent interest feature in the Debentures is an embedded derivative instrument. The first contingent cash interest payment period does not commence until February 1, 2012, and the fair market value for the embedded derivative was zero as of September 30, 2008.

**Note 13. Related-Party Transactions**

We are party to an agreement with Quezon Power, Inc. ( Quezon ), in which we hold a 26% equity investment, where we assumed responsibility for the operation and maintenance of Quezon s coal-fired electricity generation facility. Accordingly, 26% of the net income of Quezon is reflected in our statement of income and as such, 26% of the revenue earned under the terms of the operation and maintenance agreement is eliminated against Equity in Net Income from Unconsolidated Investments. For the three months ended September 30, 2008 and 2007, we collected $7.5 million and $9.6 million, respectively, and for the nine months ended September 30, 2008 and 2007, we collected $27.7 million and $27.6 million, respectively, for the operation and maintenance of the facility. As of September 30, 2008 and December 31, 2007, the net amount due to Quezon was $4.4 million and $1.1 million, respectively, which represents advance payments received from Quezon for operation and maintenance costs.

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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES**

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

**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 ultimate 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.

***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 ultimate 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 consolidated financial position or results of operations.

In June 2001, the Environmental Protection Agency ( EPA ) named Covanta Haverhill, Inc. ( Haverhill ), as a potentially responsible party ( PRP ) at the Beede Waste Oil Superfund Site, Plaistow, New Hampshire ( Beede site ). On December 15, 2006, Haverhill together with numerous other PRPs signed the Beede Waste Oil Superfund Site RD/RA Consent Decree with respect to remediation of the Beede site. The Consent Decree was entered by the U.S. District Court in New Hampshire on July 22, 2008, and on October 1, 2008, Haverhill resolved its previously recorded liability under the Consent Decree by means of a payment to the Beede Waste Oil Superfund Site Settlement Trust. Haverhill s ultimate liability at the Beede site was not material to its financial position and results of operations.

In August 2004, EPA notified Covanta Essex Company ( Essex ) that it was potentially liable 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 at least 73 PRPs named thus far that have joined the LPRSA PRP group. On May 8, 2007, EPA and the PRP group entered into an Administrative Order on Consent by which the PRP group is undertaking a Remedial Investigation/Feasibility Study ( Study ) of the LPRSA under EPA oversight. The cost to complete the Study is estimated at $37 million, in addition to EPA oversight costs. 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 costs that may be required of PRPs to remediate the LPRSA or costs associated with natural resource damages to the LPRSA that may be assessed against PRPs. 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 in comparison; however, it is not possible at this time to predict that outcome with certainty or to estimate Essex s ultimate liability in the matter, including for LPRSA remedial costs and/or natural resource damages.

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COVANTA HOLDING CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

***Other Matters***

Other commitments as of September 30, 2008 were as follows (in thousands):

| | Commitments Expiring by Period | | |
|---|---|---|---|
| | Total | Less Than One Year | More Than One Year |
| Letters of credit | $ 318,244 | $ 60,289 | $ 257,955 |
| Surety bonds | 61,993 | | 61,993 |
| Total other commitments net | $ 380,237 | $ 60,289 | $ 319,948 |

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 Loan Facility.

The surety bonds listed on the table above relate primarily to performance obligations ($53.0 million) and support for closure obligations of various energy projects when such projects cease operating ($9.0 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 Debentures. These are:

- 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 6 of the Notes to Consolidated Financial Statements in our Form 10-K.

We have issued or are party to performance guarantees and related contractual support obligations undertaken pursuant to agreements to construct and operate domestic and international 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 financing for a project. With respect to our domestic and international 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 on 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 domestic and international 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, either on domestic or international projects.

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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Concluded)**

## Note 15. Subsequent Event

During the quarter ended September 30, 2008, we were informed by Stanislaus County, California, our client community at our Stanislaus energy-from-waste facility, of its intent to prepay the project debt, all of which is variable rate, associated with that facility. As of September 30, 2008, project debt related to the Stanislaus facility of $21.3 million ($7.4 million is payable in January 2009 and $13.9 million is payable in January 2010) was included in our condensed consolidated financial statements. As of September 30, 2008, restricted funds for debt principal (classified as restricted funds held in trust) related to the Stanislaus facility of $21.3 million was included in our condensed consolidated financial statements. On October 1, 2008, approximately $18.4 million of Stanislaus facility project debt was prepaid, with the remainder expected to be prepaid in December 2008.

## 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 following discussion addresses our financial condition as of September 30, 2008 and our results of operations for the three and nine months ended September 30, 2008, 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, 2007 and Management s Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K for the year ended December 31, 2007 and in the interim unaudited financial statements and notes included in our Quarterly Reports on Form 10-Q for the periods ended March 31, 2008 and June 30, 2008, 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 a leading developer, owner and operator of infrastructure for the conversion of waste to energy (known as energy-from-waste ), as well as other waste disposal and renewable energy production businesses in the Americas, Europe and Asia. 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 engage in the independent power production business outside the United States.

We own, have equity investments in, and/or operate 58 energy generation facilities, 48 of which are in the United States and 10 of which are located outside the United States. Our energy generation facilities use a variety of fuels, including municipal solid waste, wood waste (biomass), landfill gas, water (hydroelectric), natural gas, coal, and heavy fuel-oil. We also own or operate several businesses that are associated with our energy-from-waste business, including a waste procurement business, four landfills, and several waste transfer stations.

Our mission is to be the world s leading energy-from-waste company, with a complementary network of renewable energy generation and waste disposal assets. We expect to build value for our stockholders by satisfying our clients waste disposal and energy generation needs with safe, reliable and environmentally superior solutions. In order to accomplish this mission and create additional value for our stockholders, we are focused on:

- providing customers with superior service and effectively managing our existing businesses;
- generating sufficient cash to meet our liquidity needs and invest in the business; and
- developing new projects and making acquisitions to grow our business in the Americas, Europe and Asia.

We believe that our business offers solutions to public sector leaders around the world in two related elements of critical infrastructure: waste disposal and renewable energy generation. We believe that the environmental benefits of energy-from-waste, as an alternative to landfilling, are clear and compelling: utilizing energy-from-waste reduces greenhouse gas emissions, lowers the risk of groundwater contamination, and conserves land. At the same time, energy-from-waste generates clean, reliable energy from a renewable fuel source, thus reducing dependence on fossil

fuels, the combustion of which is itself a major contributor to greenhouse gas emissions. As public planners in the Americas, Europe and Asia address their needs for more environmentally sensitive waste disposal and energy generation in the years ahead, we believe that energy-from-waste will be an increasingly attractive alternative. We will also consider, for application in domestic and international markets, acquiring or developing new technologies that complement our existing renewable energy and waste services businesses.

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. The extent to which we are successful in growing our business will depend in part on our ability to

effectively communicate the benefits of energy-from-waste to public planners seeking waste disposal solutions, and to policy makers seeking to encourage renewable energy technologies as viable alternatives to reliance on fossil fuels as a source of energy.

***Acquisitions and Business Development***

In our domestic business, we are pursuing additional growth opportunities through project expansions, new energy-from-waste and other renewable energy projects, contract extensions, acquisitions, and businesses ancillary to our existing business, such as additional waste transfer, transportation, processing and landfill businesses.

We are also pursuing international waste and/or renewable energy business opportunities, particularly in markets where the market demand, regulatory environment or other factors encourage technologies such as energy-from-waste in order to reduce dependence on landfilling for waste disposal and fossil fuels for energy production in order to reduce greenhouse gas production. In particular, we are focusing on the United Kingdom, Ireland and China, and are also pursuing opportunities in certain other markets in Europe, such as Italy, and in Canada and other markets in the Americas.

*2008 acquisitions and business development*

***Domestic Business:***

We entered into a new service fee type contract with the Pasco County Commission in Florida which commences on January 1, 2009 and extends the existing contract from 2011 to 2016.

We entered into an agreement to purchase two biomass energy facilities from co-owners Ridgewood Maine, L.L.C. and Indeck Energy Services, Inc. The two nearly identical facilities, located in West Enfield and Jonesboro, Maine, will add a total of 49 gross megawatts ( MW ) to our renewable energy portfolio. We intend to sell the electric output and renewable energy credits from these new facilities into the New England market. We have agreed to acquire these two facilities for approximately $87 million, net of cash acquired. The transaction will be funded from cash on hand and/or by drawing upon our existing revolving loan facility. Closing of the acquisition remains subject to receipt of certain regulatory approvals, approval by Ridgewood s shareholders, and certain other conditions which must be satisfied by October 31, 2008.

We entered into a new tip fee type contract with the City of Indianapolis for a term of 10 years commencing upon expiration of the existing service fee type contract in December 2008.

We entered into various agreements with multiple partners for the development, testing or licensing of new technologies related to the transformation of waste materials into renewable fuels or the generation of energy. Initial licensing fees and demonstration unit purchases approximated $4.3 million during 2008.

We acquired an energy-from-waste facility in Tulsa, Oklahoma from The CIT Group/Equipment Financing, Inc. for cash consideration of approximately $12.7 million. The design capacity of the facility is 1,125 tons per day ( tpd ) of waste and gross electric capacity of 16.5 MW. This facility was shut down by the prior owner in the summer of 2007 and we are planning to return two of the facility s three boilers to service before the end of 2008, and return its third boiler to service during 2009. During the nine months ended September 30, 2008, we have invested approximately $2.3 million in capital improvements to restore the operational performance of the facility.

We acquired a landfill in Peabody, Massachusetts for approximately $7.4 million in cash. We expect to utilize this landfill for disposal of ash from energy-from-waste facilities in the Northeast United States, including those that we own or operate.

***International Business:***

We and Chongqing Iron & Steel Company (Group) Limited have entered into a 25 year contract to build, own, and operate an 1,800 tpd energy-from-waste facility for Chengdu Municipality in Sichuan Province, Peoples Republic of China. In connection with this award, we invested $17.1 million for a 49% equity interest in the project joint venture. The Chengdu project is expected to commence construction in late 2008 or early 2009, and commence operations in 2011.

*2007 acquisitions and business development*

***Domestic Business:***

We acquired the operating businesses of EnergyAnswers Corporation ( EnergyAnswers ) for approximately $41 million in cash. We also assumed net debt of $21 million ($23 million of consolidated indebtedness net of $2 million of restricted funds held in trust). These businesses include a 400 tpd energy-from-waste facility in Springfield, Massachusetts and a 240 tpd energy-from-waste facility in Pittsfield, Massachusetts. Both energy-from-waste projects have tip fee type contracts. Approximately 75% of waste revenues are contracted for at these facilities. In addition, we acquired businesses that include a landfill operation in Springfield, Massachusetts, which is used for ash disposal; and two transfer stations, one in Canaan, New York, permitted to transfer 600 tpd of waste, and the other located at the Springfield energy-from-waste facility, permitted to transfer 500 tpd of waste. We subsequently sold certain assets acquired in this transaction for a total consideration of $5.8 million during the fourth quarter of 2007 and the first quarter of 2008.

We acquired Central Valley Biomass Holdings, LLC ( Central Valley ) from The AES Corporation. Under the terms of the purchase agreement, we paid $51 million in cash, plus approximately $5 million in cash related to post-closing adjustments and transaction costs. Central Valley owns two biomass energy facilities and a biomass energy fuel management business, all located in California s Central Valley. These facilities added 75 MW to our portfolio of renewable energy plants. In addition, we invested approximately $8 million prior to December 31, 2007, and approximately $11 million during the nine months ended September 30, 2008 in capital improvements to increase the facilities productivity and improve environmental performance. As of September 30, 2008, these capital improvements have been completed.

We entered into a new tip fee type contract with the Town of Hempstead in New York for a term of 25 years commencing upon expiration of the existing contract in 2009.

We acquired two waste transfer stations in Westchester County, New York from Regus Industries, LLC for cash consideration of approximately $7.3 million. These facilities increased our total waste capacity by approximately 1,150 tpd and enhance our portfolio of transfer stations in the Northeast United States.

We acquired a waste transfer station in Holliston, Massachusetts from Casella Waste Systems Inc. for cash consideration of approximately $7.5 million. This facility increased our total waste capacity by approximately 700 tpd. In addition, we invested approximately $4.2 million prior to December 31, 2007 and approximately $1 million during the nine months ended September 30, 2008 in capital improvements to enhance the environmental and operational performance of the transfer station.

We completed the expansion and commenced the operation of the expanded energy-from-waste facility located in and owned by Lee County in Florida. We expanded waste processing capacity from 1,200 tpd to 1,836 tpd and increased gross electricity capacity from 36.9 MW to 57.3 MW. As part of the agreement to implement this expansion, we received a long-term operating contract extension expiring in 2024.

On May 29, 2007, we entered into a ten year agreement to maintain and operate an 800 tpd energy-from-waste facility located in Harrisburg, Pennsylvania and have a right of first refusal to purchase the facility. Under the agreement, the term of which commenced February 1, 2008 following satisfaction of certain conditions precedent, we will earn a base annual service fee of approximately $10.5 million, which is subject to annual escalation and certain performance-based adjustments. We also have agreed to provide construction management services and to advance up to $25.5 million in funding for certain facility improvements required

to enhance facility performance, the repayment of which is guaranteed by the City of Harrisburg. As of September 30, 2008, we advanced $2.4 million under this funding arrangement. The facility improvements are expected to be completed by mid 2009.

We designed, constructed, operate and maintain the 1,200 tpd mass-burn energy-from-waste facility located in and owned by Hillsborough County in Florida. In August 2005, we entered into agreements with Hillsborough County to implement an expansion, and to extend the agreement under which we operate the facility to 2027. During 2006, environmental and other project related permits were secured and the expansion construction commenced on December 29, 2006. Completion of the expansion, and commencement of the operation of the expanded project, is expected in 2009.

***International Business:***

We purchased a 40% equity interest in Sanfeng Covanta Environmental Industry Co., Ltd. ( Sanfeng ), a company located in Chongqing Municipality, Peoples Republic of China. Sanfeng is engaged in the business of owning and operating energy-from-waste projects and providing design and engineering, procurement and construction services for energy-from-waste facilities in China. Sanfeng currently owns minority equity interests in two 1,200 metric tpd 24 MW mass-burn energy-from-waste projects. Chongqing Iron & Steel Company (Group) Limited holds the remaining 60% equity interest in Sanfeng. We paid approximately $10 million in connection with our investment in Sanfeng. We expect to utilize Sanfeng as a key component of our effort to grow our energy-from-waste business in China. We expect to make additional investments as and when Sanfeng is successful in developing additional projects.

In December 2007, we entered into a joint venture with Guangzhou Development Power Investment Co., Ltd. through which we intend to develop energy-from-waste projects in Guangdong Province, Peoples Republic of China. We hold a 40% equity interest in the joint venture entity, Guangzhou Development Covanta Environmental Energy Co., Ltd ( GDC Environmental Energy ), and on June 6, 2008, we invested $1.5 million in this joint venture following receipt of final government approvals. We expect to make additional investments as and when GDC Environmental Energy is successful in developing projects.

We announced that we have entered into definitive agreements for the development of a 1,700 metric tpd energy-from-waste project serving the City of Dublin, Ireland and surrounding communities. The Dublin project, which marks our most significant entry to date into the European waste and renewable energy markets, is being developed and will be owned by Dublin Waste to Energy Limited, which is co-owned by us and DONG Energy Generation A/S. As part of the transaction, we purchased a controlling stake in Dublin Waste to Energy Limited. Under the Dublin project agreements, several customary conditions must be satisfied before construction can begin, including the issuance of all required licenses and permits. The permitting process is underway and construction is expected to commence in late 2008 or early 2009.

We are responsible for the design and construction of the project, which is estimated to cost approximately 300 million euros and will require 36 months to complete. We will operate and maintain the project for Dublin Waste to Energy Limited, which has a 25-year Tip Fee type contract with Dublin to provide disposal service for approximately 320,000 metric tons of waste annually. The project is structured on a build-own-operate-transfer model, where ownership will transfer to Dublin after the 25-year term, unless extended. The project is expected to sell electricity into the local grid under short-term arrangements. We and DONG Energy Generation A/S have committed to provide financing for all phases of the project, and we expect to arrange for project financing.

**Business Segments**

Our reportable segments are Domestic and International, which are comprised of our domestic and international waste and energy services operations, respectively.

***Domestic***

For all energy-from-waste projects, we receive 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 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. For these projects, we receive revenue from electricity sales, and in some cases cash from equity distributions.



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*International*

We have ownership interests in and/or operate facilities internationally, including independent power production facilities in the Philippines, Bangladesh and India where we generate electricity by combusting coal, natural gas and heavy fuel-oil, and energy-from-waste facilities in China and Italy. We receive revenue from operating fees, electricity and steam sales, and in some cases cash from equity distributions.

**Contract Structures**

We have 24 energy-from-waste projects where we charge a fixed fee (which escalates over time pursuant to contractual indices that we believe are appropriate to reflect price inflation) for operation and maintenance services. We refer to these projects as having a Service Fee structure. Our contracts at Service Fee projects provide revenue that does not materially vary based on the amount of waste processed or energy generated and as such is relatively stable for the contract term. In addition, at most of our Service Fee projects, the operating subsidiary retains only a fraction of the energy revenues generated, with the balance used to provide a credit to the municipal client against its disposal costs. Therefore, in these projects, the municipal client derives most of the benefit and risk of energy production and changing energy prices.

We also have 14 energy-from-waste projects where we receive a per-ton fee under contracts for processing waste. We refer to these projects as having a Tip Fee structure. At Tip Fee projects, we generally enter into long-term waste disposal contracts for a substantial portion of project disposal capacity and retain all of the energy revenue generated. These Tip Fee service agreements include stated fixed fees earned by us for processing waste up to certain base contractual amounts during specified periods. These Tip Fee service agreements also set forth the per-ton fees that are payable if we accept waste in excess of the base contractual amounts. The waste disposal and energy revenue from these projects is more dependent upon operating performance and, as such, is subject to greater revenue fluctuation to the extent performance levels fluctuate.

Under both structures, 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 domestic renewable energy projects and international independent power 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 approximately three quarters 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 this revenue is comprised of waste revenue, which is generally not subject to material price volatility. Energy and metal pricing tends to be more volatile, but our exposure to these markets is a relatively small portion of our total revenue. During the third quarter of 2008, pricing for energy and recycled metals reached historic high levels and has subsequently declined.

At some of our domestic renewable energy and international independent power projects, our operating subsidiaries purchase fuel in the open markets which exposes us to fuel price risk. At other plants, fuel costs are contractually included in our electricity revenues, or fuel is provided by our customers. In some of our international projects, the

project entity (which in some cases is not our subsidiary) has entered into long-term fuel purchase contracts that protect the project from changes in fuel prices, provided counterparties to such contracts perform their commitments.

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**Seasonal Effects**

Our quarterly operating income from domestic and international operations 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 units temporarily cease operations. During these scheduled maintenance periods, we incur material repair and maintenance expenses and receive less revenue until the boiler units resume operations. This scheduled maintenance typically occurs during periods of off-peak electric demand in the spring and fall. The spring scheduled maintenance period is typically more extensive than scheduled maintenance conducted during the fall. As a result, we typically incur the highest maintenance expense in the first half of the year. Given these factors, we typically experience lower operating income from our projects during the first six months of each year and higher operating income during the second six months of each year.

**Contract Duration**

We operate energy-from-waste projects under long-term agreements. For those projects we own, our contract to sell the project s energy output (either electricity or steam) generally expires at or after the date when the initial term of our contract to operate or receive waste also expires. Expiration of these contracts will subject us to greater market risk in maintaining and enhancing revenues as we enter into new contracts. Following the expiration of the initial contracts, we intend to enter into replacement or additional contracts for waste supplies and will sell our energy output either into the regional electricity grid or pursuant to new contracts. Because project debt on these facilities will be paid off at such time, we believe that we will be able to offer disposal services at rates that will attract sufficient quantities of waste and provide acceptable revenues. For those projects we operate but do not own, prior to the expiration of the initial term of our operating contract, we will seek to enter into renewal or replacement contracts to continue operating such projects. We will seek to bid competitively in the market for additional contracts to operate other facilities as similar contracts of other vendors expire.

**RESULTS OF OPERATIONS**

The comparability of the information provided below with respect to our revenues, expenses and certain other items was affected by several factors. As outlined above under *Acquisitions and Business Development*, our acquisition and business development initiatives resulted in various additional projects which increased comparative 2008 revenues and expenses. These factors must be taken into account in developing meaningful comparisons between the periods compared below. The following general discussions should be read in conjunction with the condensed consolidated financial statements and the Notes thereto and other financial information appearing and referred to elsewhere in this report.

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**Consolidated Results of Operations — Comparison of Results for the Three and Nine Months Ended September 30, 2008 vs. Results for the Three and Nine Months Ended September 30, 2007**

| | For the Three Months Ended September 30, | | For the Nine Months Ended September 30, | | Variance Increase/(Decrease) | |
|---|---|---|---|---|---|---|
| | 2008 | 2007 | 2008 | 2007 | Three Month | Nine Month |
| | (Unaudited, in thousands) | | | | | |
| **CONSOLIDATED RESULTS OF OPERATIONS:** | | | | | | |
| Total operating revenues | $ 438,671 | $ 352,350 | $ 1,250,433 | $ 1,037,699 | $ 86,321 | $ 212,734 |
| Total operating expenses | 350,588 | 280,723 | 1,055,056 | 880,580 | 69,865 | 174,476 |
| **Operating income** | 88,083 | 71,627 | 195,377 | 157,119 | 16,456 | 38,258 |
| **OTHER INCOME (EXPENSE):** | | | | | | |
| Investment income | 1,520 | 1,963 | 4,212 | 8,966 | (443) | (4,754) |
| Interest expense | (10,593) | (16,018) | (35,876) | (51,996) | (5,425) | (16,120) |
| Loss on extinguishment of debt | | (65) | | (32,071) | (65) | (32,071) |
| Total other expense | (9,073) | (14,120) | (31,664) | (75,101) | (5,047) | (43,437) |
| **Income before income tax expense, minority interests and equity in net income from unconsolidated investments** | 79,010 | 57,507 | 163,713 | 82,018 | 21,503 | 81,695 |
| Income tax expense | (31,687) | (23,768) | (65,483) | (34,414) | 7,919 | 31,069 |
| Minority interests | (3,166) | (2,055) | (7,260) | (5,544) | 1,111 | 1,716 |
| Equity in net income from unconsolidated investments | 5,543 | 6,731 | 18,355 | 16,153 | (1,188) | 2,202 |
| **NET INCOME** | $ 49,700 | $ 38,415 | $ 109,325 | $ 58,213 | 11,285 | 51,112 |
| **WEIGHTED AVERAGE COMMON SHARES OUTSTANDING:** | | | | | | |
| Basic | 153,411 | 153,035 | 153,321 | 152,504 | 376 | 817 |
| Diluted | 154,833 | 154,319 | 154,751 | 153,844 | 514 | 907 |

| **EARNINGS PER SHARE:** | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Basic | $ | 0.32 | $ | 0.25 | $ | 0.71 | $ | 0.38 | $ | 0.07 | $ | 0.33 |
| Diluted | $ | 0.32 | $ | 0.25 | $ | 0.71 | $ | 0.38 | $ | 0.07 | $ | 0.33 |

*Operating Income*

Operating revenues increased by $86.3 million and $212.7 million for the three and nine months ended September 30, 2008, as compared to the same periods in 2007, primarily due to increased waste and energy revenues at our energy-from-waste facilities and additional revenues from new businesses acquired during 2008 and 2007 in the Domestic segment as discussed below. Operating revenues also increased due to increased demand from the electricity offtaker and resulting higher electricity generation at our Indian facilities in the International segment.

Operating expenses increased by $69.9 million and $174.5 million for the three and nine months ended September 30, 2008, as compared to the same periods in 2007, primarily due to increased plant operating expenses resulting from additional operating and maintenance costs from new businesses acquired during 2008 and 2007 in the Domestic segment as discussed below. Higher fuel costs, resulting from increased demand from the electricity offtaker and resulting higher electricity generation, at our Indian facilities also increased in the International segment. Operating expenses for the nine months ended September 30, 2007 include a write-down of assets related to a fire at our SEMASS energy-from-waste facility on March 31, 2007.

Additional detail related to operating revenues and operating expenses is provided in the reported Domestic and International segment discussions below.

*Other Components of Net Income*

Total investment income decreased by $0.4 million and $4.8 million for the three and nine months ended September 30, 2008, as compared to the same periods in 2007, primarily due to lower invested cash balances and lower interest rates.

Interest expense decreased by $5.4 million and $16.1 million for the three and nine months ended September 30, 2008, as compared to the same periods in 2007, primarily due to lower floating interest rates on the Term Loan Facility and lower debt balances and interest rates resulting from the 2007 recapitalization. As a result of the recapitalization in the first quarter of 2007, we recognized a loss on extinguishment of debt charge of approximately $32.1 million, pre-tax. See Note 6. Changes in Capitalization of the Notes to the Condensed Consolidated Financial Statements for additional information.

Income tax expense increased by $7.9 million for the three months ended September 30, 2008, as compared to the same period in 2007, primarily due to increased pre-tax income resulting from increased waste and service revenues at our energy-from-waste facilities and additional revenues from new businesses acquired.

Income tax expense increased by $31.1 million for the nine months ended September 30, 2008, as compared to the same period in 2007, due to the absence of both the write-down of assets related to SEMASS and the loss on extinguishment of debt which occurred during the nine months ended September 30, 2007, combined with increased pre-tax income resulting from increased waste and service revenues at our energy-from-waste facilities and additional revenues from new businesses acquired.

Equity in net income from unconsolidated investments decreased by $1.2 million for the three months ended September 30, 2008, as compared to the same period in 2007, primarily due to the timing of a dividend from our Trezzo facility in Italy which was recognized in the third quarter of 2007.

Equity in net income from unconsolidated investments increased by $2.2 million for the nine months ended September 30, 2008, as compared to the same period in 2007, primarily due to increased earnings from the Quezon facility of $3.7 million resulting from the strengthening of the U.S. Dollar against the Philippine Peso, partially offset

by lower dividend income from the Trezzo facility.



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**Domestic Results of Operations Comparison of Results for the Three and Nine Months Ended September 30, 2008 vs. Results for the Three and Nine Months Ended September 30, 2007**

| | For the Three Months Ended September 30, | | For the Nine Months Ended September 30, | | Variance Increase/(Decrease) | |
|---|---|---|---|---|---|---|
| | 2008 | 2007 | 2008 | 2007 | Three Month | Nine Month |
| | (Unaudited, in thousands) | | | | | |
| Waste and service revenues | $ 237,271 | $ 211,142 | $ 695,826 | $ 626,021 | $ 26,129 | $ 69,805 |
| Electricity and steam sales | 104,747 | 87,230 | 291,470 | 237,974 | 17,517 | 53,496 |
| Other operating revenues | 12,930 | 14,019 | 41,665 | 36,755 | (1,089) | 4,910 |
| Total operating revenues | 354,948 | 312,391 | 1,028,961 | 900,750 | 42,557 | 128,211 |
| Plant operating expenses | 179,428 | 160,174 | 565,226 | 488,202 | 19,254 | 77,024 |
| Depreciation and amortization expense | 49,775 | 48,140 | 145,160 | 140,300 | 1,635 | 4,860 |
| Net interest expense on project debt | 12,341 | 10,893 | 36,707 | 36,270 | 1,448 | 437 |
| General and administrative expenses | 17,782 | 15,827 | 57,064 | 52,805 | 1,955 | 4,259 |
| Write-down of assets, net of insurance recoveries | | | | 4,925 | | (4,925) |
| Other operating expenses | 11,921 | 11,175 | 42,196 | 33,751 | 746 | 8,445 |
| Total operating expenses | 271,247 | 246,209 | 846,353 | 756,253 | 25,038 | 90,100 |
| Operating income | $ 83,701 | $ 66,182 | $ 182,608 | $ 144,497 | 17,519 | 38,111 |

*Operating Revenues*

Variances in revenues for the domestic segment are as follows (in millions):

| | Domestic Segment Operating Revenue Variances | | | | | |
|---|---|---|---|---|---|---|
| | Three Months | | | Nine Months | | |
| | Existing Business | New Business(A) | Total | Existing Business | New Business(B) | Total |
| Waste and service revenues | | | | | | |
| Service fee | $ 3.3 | $ | $ 3.3 | $ 6.5 | $ 0.6 | $ 7.1 |
| Tip fee | 2.9 | 10.6 | 13.5 | 7.5 | 29.9 | 37.4 |
| Recycled metal | 9.0 | 0.3 | 9.3 | 24.3 | 1.0 | 25.3 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Total waste and service revenues | 15.2 | 10.9 | 26.1 | 38.3 | 31.5 | 69.8 |
| Electricity and steam sales | 16.6 | 0.9 | 17.5 | 32.0 | 21.5 | 53.5 |
| Other operating revenues | (1.1) | | (1.1) | 4.9 | | 4.9 |
| Total operating revenues | $ 30.7 | $ 11.8 | $ 42.5 | $ 75.2 | $ 53.0 | $ 128.2 |

(A) This column represents the results of operations for the three months ended September 30, 2008 for businesses acquired after September 30, 2007.

(B) This column represents the results of operations for the nine months ended September 30, 2008 for businesses acquired after September 30, 2007, plus the results of operations for the six months ended June 30, 2008 for businesses acquired during the quarter ended June 30, 2007, plus results of operations for the three months ended March 31, 2008 for businesses acquired during the quarter ended March 31, 2007.

Revenues from Service Fee arrangements for existing business increased from the three and nine month comparative periods primarily due to contractual escalations, partially offset by lower revenues earned explicitly to service project debt of $1.0 million and $3.9 million for the three and nine month comparative periods, respectively.

Revenues from Tip Fee arrangements for existing business increased from the three month comparative period by $2.9 million as a result of higher volumes. The increase from the nine month comparative period was due to increased production in part due to the impact of a fire in 2007 at our SEMASS energy-from-waste facility and an increase in waste volume handled, partially offset by slightly lower pricing.

Recycled metal revenues were $17.3 million and $7.9 million for the three months ended September 30, 2008 and 2007, respectively, and $47.7 million and $22.4 million for the nine months ended September 30, 2008 and 2007, respectively. Recycled metal revenues increased primarily due to higher pricing. In addition, recovered metal volume increased due to the installation of new metal recovery systems, as well as due to enhancements made to existing systems.

Electricity and steam sales for existing business increased from the three and nine month comparative periods primarily due to higher energy rates, and increased production primarily from the biomass facilities.

During the three and nine months ended September 30, 2008, we have experienced historically high recycled metals and energy prices.

Other operating revenue variances are primarily related to construction revenue timing.

*Operating Expenses*

Variances in plant operating expenses for the domestic segment are as follows (in millions):

| | Domestic Segment Plant Operating Expense Variances | | | | | |
|---|---|---|---|---|---|---|
| | Three Months | | | Nine Months | | |
| | Existing Business | New Business(A) | Total | Existing Business | New Business(B) | Total |
| Total plant operating expenses | $ 8.1 | $ 11.2 | $ 19.3 | $ 28.3 | $ 48.7 | $ 77.0 |

(A) This column represents the results of operations for the three months ended September 30, 2008 for businesses acquired after September 30, 2007.

(B) This column represents the results of operations for the nine months ended September 30, 2008 for businesses acquired after September 30, 2007 plus the results of operations for the six months ended June 30, 2008 for businesses acquired during the quarter ended June 30, 2007, plus results of operations for the three months ended March 31, 2008 for businesses acquired during the quarter ended after March 31, 2007.

Existing business plant operating expenses increased by $8.1 million for the three months ended September 30, 2008, as compared to the same period in 2007, primarily due to cost escalations and higher plant maintenance costs. Existing business plant operating expenses increased by $28.3 million for the nine months ended September 30, 2008, as compared to the same period in 2007, primarily due to increased plant maintenance and cost escalations, partially offset by $5.2 million of business interruption insurance recoveries at our SEMASS facility as discussed below.

Depreciation and amortization expense increased by $1.6 million and $4.9 million for the three and nine months ended September 30, 2008, as compared to the same periods in 2007, primarily due to capital expenditures and new business.

Net interest expense on project debt increased by $1.5 million and $0.4 million for the three and nine months ended September 30, 2008, as compared to the same periods in 2007, primarily due to lower interest earned on restricted funds related to project debt.

General and administrative expenses increased by $2.0 million and $4.3 million for the three and nine months ended September 30, 2008, as compared to the same periods in 2007, primarily due to increased efforts to grow the business.

On March 31, 2007, our SEMASS energy-from-waste facility located in Rochester, Massachusetts experienced a fire in the front-end receiving portion of the facility. Damage was extensive to this portion of the facility and operations at the facility were suspended completely for approximately 20 days. As a result of this loss, we recorded an asset impairment of $18.3 million, pre-tax, in the first quarter of 2007, which represented a preliminary estimate of the net book value of the damaged assets. During the year ended December 31, 2007, we reduced the impairment recorded by $1.0 million, pre-tax, based upon additional analysis as the facility was being restored.

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The cost of repair or replacement, and business interruption losses, are insured under the terms of applicable insurance policies, subject to deductibles. During the second quarter of 2008, we received cash proceeds of $7.2 million in settlement of our business interruption claim. Insurance recoveries are recorded as a reduction to the loss related to the write-down of assets where such recoveries relate to repair and reconstruction costs, or as a reduction to plant operating expenses where such recoveries relate to other costs or business interruption losses. We recorded insurance recoveries in our condensed consolidated statements of income as follows (in millions):

| | For the Nine Months Ended September 30, | |
|---|---|---|
| | **2008** | **2007** |
| Repair and reconstruction (reduction to Write-down of assets) | $ | $ 13.3 |
| Clean-up costs (reduction to Plant operating expenses) | $ | $ 2.7 |
| Business interruption losses (reduction to Plant operating expenses) | $ 5.2 | $ 2.0 |

During the fourth quarter 2007, we recorded additional insurance recoveries of $4.0 million related to repair and reconstruction.

Other operating expenses increased by $8.4 million for the nine months ended September 30, 2008, as compared to the same period in 2007, primarily due to costs related to construction and losses on the retirement of assets. See Note 9. Supplementary Information of the Notes for additional information.

**International Results of Operations** **Comparison of Results for the Three and Nine Months Ended September 30, 2008 vs. Results for the Three and Nine Months Ended September 30, 2007**

| | For the Three Months Ended September 30, | | For the Nine Months Ended September 30, | | Variance Increase/(Decrease) | |
|---|---|---|---|---|---|---|
| | **2008** | **2007** | **2008** | **2007** | **Three Month** | **Nine Month** |
| | | | (Unaudited, in thousands) | | | |
| Waste and service revenues | $ 1,033 | $ 946 | $ 2,790 | $ 3,018 | $ 87 | $ (228) |
| Electricity and steam sales | 79,074 | 36,454 | 209,248 | 126,191 | 42,620 | 83,057 |
| Total operating revenues | 80,107 | 37,400 | 212,038 | 129,209 | 42,707 | 82,829 |
| Plant operating expenses | 66,538 | 27,700 | 178,359 | 101,240 | 38,838 | 77,119 |
| Depreciation and amortization expense | 2,184 | 2,359 | 6,929 | 6,641 | (175) | 288 |
| Net interest expense on project debt | 1,404 | 1,608 | 4,575 | 4,722 | (204) | (147) |
| General and administrative expenses | 4,874 | 1,863 | 11,928 | 5,453 | 3,011 | 6,475 |
| Other operating expenses | 896 | (1,970) | (3,308) | (3,010) | 2,866 | (298) |

| | | | | | |
|---|---|---|---|---|---|
| Total operating expenses | 75,896 | 31,560 | 198,483 | 115,046 | 44,336 | 83,437 |
| Operating income | $ 4,211 | $ 5,840 | $ 13,555 | $ 14,163 | (1,629) | (608) |

The increases in revenues and plant operating expenses under energy contracts at both Indian facilities resulted primarily from increased demand from the electricity offtaker and resulting higher electricity generation.

General and administrative expenses increased by $3.0 million for the three months ended September 30, 2008, as compared to the same period in 2007, respectively, primarily due to normal wage and benefit escalations and additional efforts to grow the business. General and administrative expenses increased by $6.5 million for the nine months ended September 30, 2008, as compared to the same period in 2007, respectively, primarily due to increased litigation expense associated with an insurance claim associated with a facility in China which was sold in 2006, normal wage and benefit escalations and additional business development spending.

Other operating expenses increased by $2.9 million for the three months ended September 30, 2008, as compared to the same period in 2007, primarily due to a $0.9 million foreign currency exchange loss and a $1.7 million gain on the sale of the Linan facility recorded in 2007. Other operating income increased by $0.3 million for the nine months ended September 30, 2008, as compared to the same period in 2007, primarily due to insurance recoveries associated with a facility in China which was sold in 2006, partially offset by the absence of the gain on sale of Linan facility in 2007 and foreign currency exchange losses.

## LIQUIDITY AND CAPITAL RESOURCES

Generating sufficient cash to invest in our business, meet our liquidity needs, pay down project debt, and pursue strategic opportunities remain important objectives of management. We derive our cash flows principally from our operations at our domestic and international projects, where our historical levels of production allow us to satisfy project debt covenants and payments, and distribute cash. We typically receive cash distributions from our domestic 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.

During the first quarter of 2007, we completed a comprehensive recapitalization utilizing a series of equity and debt financings. Under the new credit facilities, we have substantially greater, but not unrestricted, ability to make investments in our business and to take advantage of opportunities to grow our business through investments and acquisitions, both domestically and internationally.

Our primary future cash requirements will be to fund capital expenditures to maintain our existing businesses, make debt service payments and grow our business through acquisitions and business development. 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. See Management s Discussion and Analysis of Financial Condition Overview Acquisitions and Business Development above.

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.

Additionally, as of September 30, 2008, we had available credit for liquidity of $300 million under the Revolving Loan Facility (as defined below) and unrestricted cash of $169 million.

Under our Revolving Loan Facility, we have pro rata funding commitments from a large consortium of banks, including a 6.8% pro rata commitment from Lehman Brothers Commercial Bank. Lehman Brothers Commercial Bank is a subsidiary of Lehman Brothers Holdings, Inc., which filed for bankruptcy protection in September 2008. We believe that neither the Lehman Brothers Holdings, Inc. bankruptcy, nor the ability of Lehman Brothers Commercial Bank (which is not currently part of such bankruptcy proceeding) to fund it pro rata share of any draw request we may make, will have a material affect on our liquidity or capital resources.

Our projected contractual obligations are consistent with amounts disclosed in our Annual Report on Form 10-K for the year ended December 31, 2007. We believe that when combined with our other sources of liquidity, including our existing cash on hand and the Revolving Loan 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.

On September 22, 2008, we announced that our Board of Directors authorized the purchase of up to $30 million of our common stock in order to respond opportunistically to volatile market conditions. The share repurchases, if any, may take place from time to time based on market conditions and other factors. The authorization is expected to continue only for so long as recent volatile market conditions persist. During the three and nine months ended September 30, 2008, we did not repurchase shares of our common stock.

***2007 Recapitalization***

During the first quarter of 2007, we completed a comprehensive recapitalization utilizing a series of equity and debt financings including the following transactions:

- the refinancing of our previously existing credit facilities with new credit facilities, comprised of a $300 million revolving credit facility, a $320 million funded letter of credit facility, and a $650 million term loan (collectively referred to as the Credit Facilities );
- an underwritten public offering of 6.118 million shares of our common stock, from which we received proceeds of approximately $136.6 million, net of underwriting discounts and commissions;
- an underwritten public offering of approximately $373.8 million aggregate principal amount of Debentures, from which we received proceeds of approximately $364.4 million, net of underwriting discounts and commissions; and

the repayment, by means of a tender offer and redemptions, of approximately $611.9 million in aggregate principal amount of outstanding notes previously issued by certain of our intermediate subsidiaries. We completed our tender offer and redemptions for approximately $604.4 million in aggregate principal amount of outstanding notes on February 22, 2007. The remaining $7.5 million of the outstanding notes were redeemed in April 2007 and September 2007.

As a result of the recapitalization, we recognized a loss on extinguishment of debt of approximately $32.1 million, pre-tax, which was comprised of the write-down of deferred financing costs, tender premiums paid for the intermediate subsidiary debt, and a call premium paid in connection with previously existing financing arrangements. These amounts were partially offset by the write-down of unamortized premiums relating to the intermediate subsidiary debt and a gain associated with the settlement of our interest rate swap agreements.

***Credit Agreement Financial Covenants***

The loan documentation under the Credit Facilities contains customary affirmative and negative covenants and financial covenants as discussed in Note 6. Long-Term Debt of the Notes to the Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2007. As of September 30, 2008, we were in compliance with the covenants under the Credit Facilities.

The financial covenants of the Credit Facilities, which are measured on a trailing four quarter period basis, include the following:

maximum Covanta Energy leverage ratio of 4.25 to 1.00 for the four quarter period ended September 30, 2008, which measures Covanta Energy s principal amount of consolidated debt less certain restricted funds dedicated to repayment of project debt principal and construction costs ( Consolidated Adjusted Debt ) to its adjusted earnings before interest, taxes, depreciation and amortization, as calculated under the Credit Facilities ( Adjusted EBITDA ). The definition of Adjusted EBITDA in the Credit Facilities excludes certain non-cash charges. The maximum Covanta Energy leverage ratio allowed under the Credit Facilities adjusts in future periods as follows:

4.00 to 1.00 for each of the four quarter periods ended December 31, 2008, March 31, June 30 and September 30, 2009;
3.75 to 1.00 for each of the four quarter periods ended December 31, 2009, March 31, June 30 and September 30, 2010;
3.50 to 1.00 for each four quarter period thereafter;

maximum Covanta Energy capital expenditures incurred to maintain existing operating businesses of $100 million per fiscal year, subject to adjustment due to an acquisition by Covanta Energy; and

minimum Covanta Energy interest coverage ratio of 3.00 to 1.00, which measures Covanta Energy s Adjusted EBITDA to its consolidated interest expense plus certain interest expense of ours, to the extent paid by Covanta Energy.

**Sources and Uses of Cash Flow for the Nine Months Ended September 30, 2008 and 2007:**

| | For the Nine Months Ended | Increase |
|---|---|---|

| | September 30, 2008 | 2007 | (Decrease) 2008 vs 2007 |
|---|---|---|---|
| | (Unaudited, in thousands) | | |
| Net cash provided by operating activities | $ 267,498 | $ 244,324 | $ 23,174 |
| Net cash used in investing activities | (118,256) | (111,073) | 7,183 |
| Net cash used in financing activities | (129,492) | (227,390) | (97,898) |
| Effect of exchange rate changes on cash and cash equivalents | (153) | 375 | (528) |
| Net increase (decrease) in cash and cash equivalents | $ 19,597 | $ (93,764) | 113,361 |

During the first quarter of 2008, we revised our presentation of the condensed consolidated statements of cash flows to present changes in restricted funds held in trust relating to operating activities as a component of cash flow from operating activities and changes in restricted funds held in trust relating to financing activities (debt principal repayments) as a component of cash flow from financing activities; previously we included all changes in restricted funds held in trust as a component of cash flow from financing activities. For the nine months ended September 30, 2007, we have reclassified approximately $15.6 million as a component of cash flow from operating activities in order to conform to the current period presentation on the condensed consolidated statements of cash flows.

Net cash provided by operating activities for the nine months ended September 30, 2008 was $267.5 million, an increase of $23.2 million from the prior year period. The increase was primarily comprised of $56.0 million from a combination of improved operating performance and lower net interest expense. Additionally, we had an increase in non-property insurance receipts of $10.0 million (including $7.2 million of business interruption recoveries related to the SEMASS energy-from-waste facility), offset by incremental increases in restricted funds held in trust of $43.2 million.

Net cash used in investing activities for the nine months ended September 30, 2008 was $118.3 million, an increase of $7.2 million from the prior year period. The increase was primarily related to lower cash outflows for acquisitions of businesses of approximately $43.1 million, offset by higher cash outflows principally comprised of:

- $16.0 million to acquire land use rights in the United Kingdom and United States in connection with development activities;
- an increase of $18.7 million related to investments in fixed maturities at our insurance subsidiary, partially offset by an increase of $7.2 million in proceeds from the sale of investments in fixed maturities at our insurance subsidiary;
- $18.5 million of equity investments, of which $17.1 million related to the Chengdu project, offset by the $10.3 million equity investment in Sanfeng during the comparative period;
- an increase in capital expenditures of $7.1 million, which includes $3.8 million for purchases associated with alternative energy technology development: and
- $7.5 million of primarily business development activities.

Net cash used in financing activities for the nine months ended September 30, 2008 was $129.5 million, a decrease of $97.9 million from the prior year period due primarily to the 2007 recapitalization. The net proceeds from refinancing the previously existing credit facilities with the New Credit Facilities was $5.6 million, net of transaction fees. Proceeds of approximately $364.4 million and $136.6 million, each net of underwriting discounts and commissions, were received during the three months ended March 31, 2007 related to underwritten public offerings of Debentures and common stock, respectively. The combination of the proceeds from the public offerings of Debentures and common stock and approximately $130.0 million in cash and restricted cash (available for use as a result of the recapitalization) were utilized for the repayment, by means of a tender offer, of approximately $611.9 million in principal amount of outstanding notes previously issued by certain intermediate subsidiaries.

***Project Debt***

*Domestic 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 and Contingencies.* Certain subsidiaries had recourse liability for project debt which is recourse to Covanta ARC LLC, but is non-recourse to us, which as of September 30, 2008 aggregated to $251.2 million.

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*International Project Debt*

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. Project debt relating to two international projects in India is included as Project debt (short- and long-term) in our condensed consolidated financial statements. 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.

**Other Commitments and Contingencies**

Other commitments as of September 30, 2008 were as follows (in thousands):

| | Commitments Expiring by Period | | |
|---|---|---|---|
| | Total | Less Than One Year | More Than One Year |
| Letters of credit | $ 318,244 | $ 60,289 | $ 257,955 |
| Surety bonds | 61,993 | | 61,993 |
| Total other commitments net | $ 380,237 | $ 60,289 | $ 319,948 |

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 Loan Facility.

The surety bonds listed on the table above relate primarily to performance obligations ($53.0 million) and support for closure obligations of various energy projects when such projects cease operating ($9.0 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 Debentures. These are:

- 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, see Note 6. Changes in Capitalization of the Notes to the Consolidated Financial Statements included in our Audited Consolidated Financial Statements and accompanying Notes in our Annual Report on Form 10-K for the year ended December 31, 2007.

We have issued or are party to performance guarantees and related contractual support obligations undertaken pursuant to agreements to construct and operate certain domestic and international energy and waste 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 financing for a project. With respect to our domestic and international 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 on 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 domestic and international 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 material. To date, we have not incurred material liabilities under such performance guarantees, either on domestic or international projects.

**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 nine months ended September 30, 2008 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, 2007.

***Recent Accounting Pronouncements***

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

**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 interest rates, foreign currency exchange rates, and commodity prices. Our use of derivative instruments is very limited and we do not enter into derivative instruments for trading purposes.

Management believes there have been no material changes during the nine months ended September 30, 2008 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, 2007.

**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 September 30, 2008. 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 ( SEC ) rules and forms.

Our Chief Executive Officer and Chief Financial Officer believe that our disclosure controls and procedures are effective to provide such reasonable assurance.

Our management, including the 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.

### Changes in Internal Control over Financial Reporting

There has not been any change in our system of internal control over financial reporting during the most recent fiscal quarter 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 nine months ended September 30, 2008 to the risk factors discussed in Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2007.

### ITEM 2. *UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS*

None.

### ITEM 3. *DEFAULTS UPON SENIOR SECURITIES*

None.

### ITEM 4. *SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS*

None.

### ITEM 5. *OTHER INFORMATION*

(a) On October 22, 2008, and effective as of January 1, 2009, we and certain of our subsidiaries entered into substantially identical amendments to employment agreements with our named executive officers in order to comply with and clarify the treatment of certain payments which may be made under such agreements pursuant to section 409A of the Internal Revenue Code. The amendments did not alter the amounts or timing of any payments under the respective employment agreements. A copy of the form of amendment is attached hereto and incorporated herein by reference.

(b) Not applicable.

### ITEM 6. *EXHIBITS*

| Exhibit Number | Description |
|---|---|
| 10.1 | Form of Amendment to Employment Agreements with<br>a. Anthony J. Orlando, President and Chief Executive Officer;<br>b. Mark A. Pytosh, Executive Vice President and Chief Financial Officer;<br>c. John M. Klett, Executive Vice President and Chief Operating Officer;<br>d. Timothy J. Simpson, Executive Vice President, General Counsel and Secretary;<br>e. Seth Myones, President, Americas Covanta Energy<br>and certain subsidiaries, dated October 22, 2008, and effective as of January 1, 2009. |

| | |
|---|---|
| 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. |

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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/ Mark A. Pytosh

Mark A. Pytosh
Executive Vice President and Chief Financial Officer

By: /s/ Thomas E. Bucks

Thomas E. Bucks
Vice President and Chief Accounting Officer

Date: October 22, 2008

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