Covanta Holding Corporation

2006 Second Quarter

Prepared Remarks

August 4, 2006

OPERATOR

Good morning, everyone, and welcome to the Covanta Holding Corporation second quarter 2006 financial results conference call and webcast. This call is being recorded.

At this time, for opening remarks and introductions, I'd like to turn the call over to the Treasurer, Liz O'Melia. Please go ahead.

LIZ O'MELIA

Thank you and good morning. Welcome to Covanta Holding Corporation's second quarter 2006 conference call. Presenting on the call today will be Covanta's CEO and president, Tony Orlando; and our senior vice president and CFO, Craig Abolt. They will provide an operational update, review our financial results and then they will take your questions.

In order to provide everyone an opportunity to ask a question, please limit yourself to one question and one follow-up.

Before turning it over to Tony, I would like to refer you to our forward-looking disclaimer:

This conference call includes forward-looking statements within the meaning of Section 27-A of the Securities Act of 1933, and Section 21-E of the Securities Exchange Act of 1934. Such statements include declarations regarding the intent, belief, or current expectations of the company and its management. Prospective investors are cautioned that any such forward-looking statements are not guarantees of future performance, and involve a number of risks and uncertainties that can materially affect actual results as identified from time to time in the company's Reports and Registration Statements filed with the Securities and Exchange Commission. The information presented includes non-GAAP financial measures. A reconciliation to the most directly comparable GAAP measure and management’s reasons for presenting such information are set forth in the exhibits to our press release that were issued last night.

For your reference, we have also provided supplemental information about our overall revenues on our website, which will assist you in following this discussion.

I will now turn the call over to Tony Orlando, our CEO and President.

TONY ORLANDO

Thanks, Liz. And thank you all for joining us today. It has been a terrific first half of the year for Covanta in many respects.

Our portfolio of facilities is once again achieving remarkably consistent performance with WTE boiler availability above 90%. This keeps us on track to safely convert 15 million tons of waste into clean renewable energy by the end of the year. With this solid operating platform as our base, we are posting very strong financial results. Through June, our domestic waste and energy revenues are up 4.7% on a comparable basis which is more than we would typically expect given our highly contracted revenue.

Craig will review the top line in more detail, but in summary - the first half of the year was good on all fronts:

- We're benefiting from last year's reorganization of our Warren County New Jersey facility;
- Our production is up slightly from last year;
- Electricity pricing is up as well;
- Tip fees have increased modestly;
- Contractual service fees have escalated linked to increases in CPI and PPI; and
- Last but not least, we've seen a jump in scrap metal pricing.

Higher revenue is not the only good news; we are also executing on cost reduction initiatives. After 6 months, we've held our domestic plant operating expense close to flat year over year on a pro forma basis, effectively absorbing not only typical inflation but also expenses relating to the Warren County facility. Our ability to achieve this has been, in part, due to benefits related to timing and the reduced scope of scheduled maintenance activities – something we will see move up and down quarter to quarter, and to a lesser extent, year to year. On the other hand we fully anticipate our cost reduction initiatives will be sustainable. These initiatives primarily relate to taking advantage of our larger scale created by last year's acquisition of Ref-Fuel. In the past we've talked about purchasing leverage and regional maintenance teams, but we didn't put a number on the potential benefit. Our people are doing an outstanding job capitalizing on these opportunities, and as a result, I can now tell you we expect to achieve an incremental $5 to $10 million a year in operating cost reductions above and beyond SG&A synergies previously discussed.

Our international team is also firing on all cylinders, maximizing the value of our assets. For example, we decided to sell one of our small coal plants in China. Doing so generated some cash but more importantly it allows our management in Asia to spend more time exploring Waste-to-Energy opportunities. And our international operating performance continues to be solid across the board. Notably the 2006 Asian Power Awards recently announced that Quezon, our largest operation, was awarded the "Best O & M Project in Asia".

In addition to our strong operating results, we've taken steps to improve our capital structure. During the past quarter we re-priced the first lien facility and moved $140 million from our second lien to the first lien. On a full year basis we expect these changes to save about $8 million pre-tax cash interest expense, and further increase our flexibility to invest in the business.

We are very proud of our strong performance for the first half of the year and remain confident in our ability to maintain this momentum through year-end. As a result, we have updated our guidance for 2006, which I will review for you after Craig's comments.

In addition, I am equally pleased with our progress on strategic growth initiatives where we are advancing opportunities in three key areas:

1. Expanding existing WTE plants;
2. Growing our Northeast waste disposal network; and
3. Developing a platform to penetrate international markets ripe for waste to energy growth.

We continue to be enthusiastic about these business development opportunities and positive about the overall market conditions that support our business objectives. Furthermore, we're in a strong liquidity position ending the quarter with approximately $160 million of unrestricted cash, thus enhancing our flexibility. And, Covanta's entire team of outstanding people remains committed to growing long-term shareholder value by capitalizing on promising opportunities to expand our leadership position in waste to energy.

Now, I'll turn it over to Craig to review the financial results.

CRAIG ABOLT

Thanks, Tony.

Total revenues for the second quarter of 2006 were $334 million, and net income was $51 million, or 35 cents per diluted share. For the six months ended June 30, 2006, total revenues were $639 million, and net income was $63 million or 43 cents per diluted share.

It was an excellent quarter. On top of our solid operating results, we had two items that contributed 12 cents during this quarter, which we do not expect to report in future periods. I'll talk more about these items later in my discussion, but in short, both were cumulative tax benefits from prior years relating to our international business.

It is also important to remember, Ref-Fuel's results are not included in our reported financials for most of the second quarter and six months of 2005 since the Ref-Fuel acquisition occurred on June 24, 2005. Therefore, in order to provide useful comparative information, my discussion will focus on 2005 pro forma results that include the Ref-Fuel business.

Let's begin with a breakdown of our revenues for the six months ended June 30, 2006. Total revenues increased by approximately $35 million or 5.8%:

- Waste and Service revenues increased $12 million or 3% to a total of $405 million;
- Energy revenues increased by more than $23 million, almost 12%, to a total of $225 million; and
- Other revenues, primarily from our insurance business, remained stable at approximately $9 million.

Looking at these components of the business in more detail…

Let's discuss the main factors driving the $12 million increase in Waste and Service revenues.

- Specifically, service fee revenues increased by approximately $2 million. This increase was primarily due to contractual escalations and higher additional waste service fees of $7 million offset by a $5 million decrease in debt service pass-through revenues.
- Tip fee revenues increased by $7 million. $3 million of this increase was due to a 1.7% rise in our average tip fee. The remaining $4 million increase relates to the addition of tip fee revenues from our Warren facility which was restructured as a tip fee deal in December 2005.
- As Tony mentioned earlier, favorable scrap metal markets drove other waste revenues up $3.5 million.

Turning to our energy revenues… we experienced higher energy rates both domestically and internationally, leading to a $23 million revenue increase overall.   Specifically,

- Domestic energy revenues increased by $11 million. $9 million of this increase related primarily to higher energy rates and also a slight increase in our energy output. The remaining $2 million was primarily due to the inclusion of electricity revenue from our Warren subsidiary. Notably, we locked in some of our uncontracted revenue for 2006 when natural gas prices were quite high and that has proven to be a good decision so far as our actual revenue under these arrangements has been about $10 per mega watt hour more than the actual average PJM grid.
- International energy revenues increased by $12 million. This increase was primarily driven by higher tariff revenues which offset our higher fuel cost.

In summary, our waste and energy revenues are up nicely and we are particularly pleased with our domestic revenue growth of 4.7%.

Expenses

Turning now to the expense side, again comparing pro forma 2005 to actual 2006 for the six months ended June 30, Covanta's total operating expenses were $527 million – an increase of approximately $10 million or 2%. The majority of this increase related to higher fuel expense at our international facilities, and as I mentioned a moment ago, our electricity prices were increased to cover this cost. When drilling down we see

- Domestic total operating expenses increased slightly by $2 million. Normal escalations such as wages and benefits as well as costs from the reorganization of our Warren subsidiary were nearly offset by our cost reduction initiatives and timing and scope of our maintenance expense.
- International total operating expenses increased by $8 million primarily due to higher fuel costs, offset by reduced generation and a $1.2 million gain on the sale of our Huantai facility in China during the second quarter of 2006.

General and administrative expenses decreased approximately a million or 2% as compared to 2005. Wage escalations and higher development costs were partially offset by synergies gained from the Ref-fuel acquisition. At the time of the acquisition, we had said we would achieve $15 – 20 million in synergy related savings by the end of 2007. Our results show that we have already succeeded in capturing almost all of these savings, and we remain on track to achieve our stated goal.

Now I’m going to turn to the two cumulative favorable tax benefits relating to our international business that contributed 12 cents to our EPS. Remember I noted that, because of this cumulative nature, we do not expect to report similar benefits in future periods.

Our prior position under APB 23 was based on distributing all international earnings back to the US. We've now changed our position under APB 23 to be consistent with our strategy to pursue international investment opportunities. The on-going benefit of this election is to reduce our overall corporate effective tax rate from 45% to 38%. There is also an impact in the current quarter of $10M or 7 cents per share which stems from the reversal of the deferred taxes that were accrued over the two years prior to the election under APB 23. Finally, it’s important to note that while the election of APB 23 will have an ongoing impact on our GAAP tax rate, there is no impact to our cash taxes.

There was also a $7 million or 5 cents per share increase in equity income. This was due to a ruling received from the Philippine tax authorities clarifying the deductibility of unrealized foreign exchange losses at the Quezon project company where we hold a minority ownership position. The project company recorded a deferred tax benefit relating to foreign exchange losses incurred in prior periods, which in turn increased our equity income this quarter.

Now let's focus on adjusted EBITDA for the first six months of the year. Adjusted EBITDA was $277 million, which includes $7 million as a result of the cumulative tax benefit. Excluding the $7 million, adjusted EBITDA was up 15%, largely due to higher operating revenues, successful execution of cost reduction initiatives and reduced scope of scheduled maintenance work.

Earnings per diluted share increased to 43 cents as a result of this strong operating performance coupled with a reduction to our effective tax rate and the inclusion of 12 cents relating to the cumulative tax benefits I previously described. Excluding the 12 cents, earnings per diluted share nearly doubled from 16 cents in 2005 to 31 cents in 2006. To sum it up, if we ignore both cumulative tax benefits relating to our international business and compare our results to last year's pro forma, we see significant adjusted EBITDA and EPS growth during the first half of the year.

Before turning it back to Tony, I'd like to provide you with a little more detail on our debt repricing. As Tony mentioned, in May, we amended our credit facilities to reprice our First Lien Term Loan and Funded Letter of Credit facilities, which reduced the interest rate on these facilities by 75 basis points. At the same time, we received commitments allowing us to increase our First Lien by $140 million and use the proceeds to pay down a portion of the higher-priced Second Lien. Our First Lien Funded Letter of Credit and Revolving Credit facilities remain unchanged at $320 million and $100 million respectively, but the letter of credit capacity available under the Revolver was increased to $90 million from $75 million.

This is going to result in a substantial reduction to our cash interest expense, enhancing our ability to either de-lever or invest in the business. We believe our ability to complete this re-pricing within a year after the Ref-Fuel acquisition is indicative of how well the overall business is performing.

Now I'm going to turn it back to Tony who will review our guidance.

TONY:

Based on our strong performance during the first half of the year and our view of what lies ahead, we decided to update our guidance on three key metrics.

Our new guidance for Covanta Energy 2006 adjusted EBITDA is within the range of [$535 to $545 million.] This includes the $7 million equity income relating to Quezon deferred tax benefit Craig discussed earlier.

We are also updating our Covanta Energy free cash flow guidance for 2006 to be approximately $235 million.

And lastly, our updated guidance for diluted EPS is approximately 75 cents for 2006 which includes the 12 cents in cumulative tax benefits relating to our international business previously discussed.

Closing

In closing, I will say once again ----

- we are quite pleased with our strong performance during the first half of 2006 and
- we remain committed to providing world class customer service to generate predictable earnings and cash flow ----
- Cash flow that we plan to use to reduce debt and to invest in the business where we have exciting prospects to grow.

With that, we look forward to answering your questions.

Operator, please open up the phone lines….

OPERATOR

Thank you. Ladies and gentlemen, in order to ask a question, simply press "star one" on your touch-tone telephone. Again, that's "star one" for questions. If you're using a speakerphone, please make sure that your mute function is turned off in order for your signal to reach our equipment. Once again, that was "star one" for any questions that you may have. We will pause for just a moment to assemble the question queue.

Closing after Q&A

Thanks again for joining us. I look forward to speaking with you again soon.