ecofin
Advisors Limited

August 03, 2021

To the Board of Directors of Covanta Holding Corporation:

Ecofin Advisors Ltd and its affiliates (“Ecofin”) are the discretionary investment managers controlling approximately 2.2 million shares of common stock of Covanta Holding Corporation ("Covanta" or “the Company”), representing approximately 1.7% of the Company’s outstanding shares, hereby inform the Covanta Board of Directors of its intention to vote against the proposed acquisition of Covanta by EQT Infrastructure (“EQT”).

The Company announcement on July 14, 2021 that it had entered into a definitive agreement to be acquired, was not at all surprising to us given the ongoing strategic review. However, we were very disappointed to read that the board endorsed the low offer price of $20.25 per common share. We believe that the offer price fails to capture the intrinsic value of Covanta and more importantly fails to capture the substantial value creation opportunities over the next few years. Below is the rationale supporting our intention to oppose this low offer.

1. On April 29, 2021, Covanta presented its financial outlook to 2024, projecting a substantial growth in EBITDA and cash flow generation vs. 2021. On the back of an announced overhead cost optimization program totalling $30 million in annual savings by 2023, asset rationalisation and growth in the UK/Ireland, Covanta projects EBITDA to grow from $470 million at the midpoint in 2021 to over $600 million in 2024 and Free Cash Flow (“FCF”) to grow from $125-155 million in 2021 to over $250 million in 2024. It is therefore quite clear that Covanta is selling itself as it is on the cusp of a structural improvement in profitability, cash flow generation and indebtedness. The Company has done much of the heavy lifting that comes about in the development of new assets, especially in the UK, and is about to start collecting the returns on these investments. The offer should reflect that creation of value, and in our view it does not.

2. The Company has an elevated beta due to its high level of debt and poor historical cash flow generation. However, we believe that situation is changing as the new management has stated clearly it wants the business to be less capital intensive. Higher FCF to 2024 reducing the indebtedness of the Company together with a stronger footing under the new CEO infer less risk going forward. Beta should therefore decline in the coming years and the equity value of the business increase as the equity risk premium declines.

3. The Company is at an inflection point in terms of cash flow generation. In the past few years, FCF generation was poor and the dividend too high, leading to rising debt levels. However, from this year on, FCF is expected to more than cover the dividend and therefore the debt level can decline in absolute terms at a time EBITDA starts rising substantially. Inputting higher FCFs, falling debt and a lower beta into our discounted cash flow model produces a much higher fair value for the Company than the offer price received from EQT. And this is even before assuming that the cost of debt might fall as the Company debt level falls and risk profile improves.

4. As the world embraces a shift away from fossil fuels and more companies pledge to reduce the amount of waste they send to landfills, the Company can reasonably foresee growing demand for its services and a higher ability to price up its “clean electrons” and “no landfill” offering. We fail to find any reflection of these structural positives in the offer price.

5. At the offer price of $20.25 per common share, the Company is valued on 10.99x 2021 EBITDA (Bloomberg consensus). This multiple is only slightly above Covanta 5-year average multiple of 10.42X despite the Company being in a much stronger financial and operational position with much stronger prospects vs. its anaemic performance in the past few years. Moreover, the multiple at the offer price is much lower than that of other companies in the waste management industry.

As the Company is on a very attractive growth and profitability path, with a much lower risk profile and attractive structural drivers over the medium to long-term, we are at a loss to understand why the Board would accept to sell the Company at a price more in line with the problematic past than the bright future and at a large discount to peers despite better relative attractiveness.

We have no reason to believe the Directors acted in or were influenced by their best personal interests. As such, in continuation with the good historical relationship between Ecofin and the Company, we hope the board will engage with disappointed shareholders.

Sincerely,

Jean-Hugues de Lamaze
Director
Ecofin Advisors Limited

Michel Sznajer
Portfolio Manager
Ecofin Advisors Limited