ecofin
Advisors Limited

September 28, 2021

To the Board of Directors of Covanta Holding Corporation:

Further to our letter to the board of Covanta on August 5, 2021 (press release link here) and the publication by Covanta of its proxy statement on September 2, 2021, we write today to reiterate our intention to vote against the existing merger proposal at the special meeting on October 12, 2021. We believe Covanta should continue as an independent company to harvest the expected value creation we highlight below, or EQT should make a fairer offer.

We contend that EQT is not paying fair value, let alone a premium, to acquire Covanta and that the board has wrongly settled for an offer that reflects the unsatisfactory track record of Covanta rather than its brighter growth outlook. The board, with Bank of America, requested a non-binding letter of interest to take over Covanta in early April (with the process completing early July). Since the second quarter, we have witnessed substantial improvements in key drivers of the business which, unfortunately, are not factored into Covanta's or Bank of America's assumptions. Moreover, momentum for decarbonisation has accelerated, driven in part by the US administration's agenda and the approach of COP26, which we believe makes Covanta's business a more attractive baseload low carbon electricity provider.

In addition to the arguments laid out in our first letter, our conviction about the inadequacy of the offer has been fortified, notably because the board's discussions with potential acquirers took place during the second quarter of 2021, thereby failing to capture some structural and cyclical improvements in the business and its growth trajectory. We encourage EQT to reassess the following:

- Low valuation: We believe EQT's offer undervalues Covanta for multiple reasons:
  - As 2021 is an inflection point in Covanta's operational performance, the valuation multiple needs to reflect the strong growth outlook or be based on 2024 when all the known growth projects are completed. Unfortunately, the analysis by Bank of America focuses on a static perspective in 2021 and 2022 rather than a dynamic, forward-looking one. Said differently, we believe Covanta should not trade on historical multiples and 2021/22 forecasts given the substantially improved growth outlook. Based on the 2024 consensus forecast, which we believe is conservative, Covanta trades on 7.6x EV/EBITDA;
  - In Exhibit 1, we present Covanta's valuation relative to a peer group selected by Covanta for its management compensation. As the chart demonstrates, at the offer price, Covanta trades on 10.9x 2021 EV/EBITDA, a discount to the peer group's 11.9x EV/EBITDA despite its faster growth. Moreover, as we can objectively question why some companies are part of the peer group, we highlight that collectively the waste peers are trading on 15.8x 2021 EV/EBITDA, a substantial premium to Covanta that in our view their growth profiles do not justify. As such, we believe Covanta is undervalued;

- In the period 2015 to 2020, Covanta's EBITDA declined by 1.8% per annum while the peer group's grew by 0.2% per annum. For the period 2021-2024, however, the consensus expects Covanta's EBITDA to grow by 8.9% per annum versus 7.4% per annum for the peer group. As Covanta's growth (and cash flow) profile is changing so dramatically between these two periods, why should the offer price value Covanta at 10.9x 2021 EV/EBITDA while the average multiple was 10.4x in the 2015-2020 period? Furthermore, this lack of recognition of the change in the company's growth profile happens while multiples for waste peers are higher and have risen over the past 5 years;

- Structural tip fee inflation: Tip fees for waste are moving higher as Covanta is a beneficiary of inflation-linked contracts, the structural move away from landfills and scarcity of alternative sites. As 2.3 tons of waste get spot tip fees and 3.8 tons have contracts expiring within 3 years, substantial volumes are due to benefit from higher tip fees. Every 1% increase in the tip fee (and service fee) adds $11mn in revenue with limited incremental expenses, equivalent to about 2% of Group EBITDA (Note: tip and service fees rose 7% in 2Q21). EQT's offer does not reflect this incremental value.

- Higher electricity prices: As of June 2021, 23% of electricity sold in 2021 was at market prices and 44% of electricity to be sold in 2022 is also neither hedged nor contracted. As electricity prices have risen an estimated 36% between the average in 2Q21 and today, Covanta could receive $9mn in incremental revenue in the second half of 2021 if electricity prices stay flat for the rest of the year or if Covanta locks in current prices. For 2022, Covanta could lock in the forward price on unhedged/uncontracted volumes and add $23mn in revenue with little offsetting expense (4.5% of consensus 2022 Group EBITDA). As the Covanta 2024 plan uses forward electricity prices as of April 2021, which are substantially below current prices, we believe the 2024 targets are too conservative. EQT's offer does not reflect this incremental value.

- Higher metal prices: HMS and Old Cast indices are trading at $420 and $0.8, respectively, compared with Covanta's assumptions of $325 and $0.625 for 2021. Factoring in quarter-to-date averages for 2H21 versus Covanta's conservative assumptions would add an estimated $17mn in revenue in 2H21 alone. Moreover, as the Covanta 2024 plan uses cautious HMS ($300) and Old Cast ($0.60) figures, the 2024 targets are excessively conservative. EQT's offer does not reflect this incremental value.

- Interest expense savings: As the capex cycle ends with the completion of the UK plants and a capital-light strategy features going forward, Covanta has indicated it expects cash flows to rise from $140mn today to over $250mn in 2024. As such, Covanta should be able to substantially reduce the debt burden and cost of debt. Covanta had a total interest expense of $128mn over the past 12 months on about $2.5bn of debt, translating into an average 5.1% cost of debt with 3 bonds amounting to $1.2bn ($400mn at $5^{7/8}$% (call 10/21), $400mn at 6% (call 1/22) and $400mn at 5%). It is reasonable to assume refinancing at a rate at least 1% below the current cost of debt for the bonds and possibly on all the debt, which would save $12-25mn per year in interest expenses. EQT's offer does not reflect this incremental value.

- Public company cost savings: Covanta had $120mn in G&A expenses in 2020, and it is reasonable to expect 10% of these expenses to be saved if Covanta becomes an unlisted entity. EQT's offer does not reflect this incremental value.

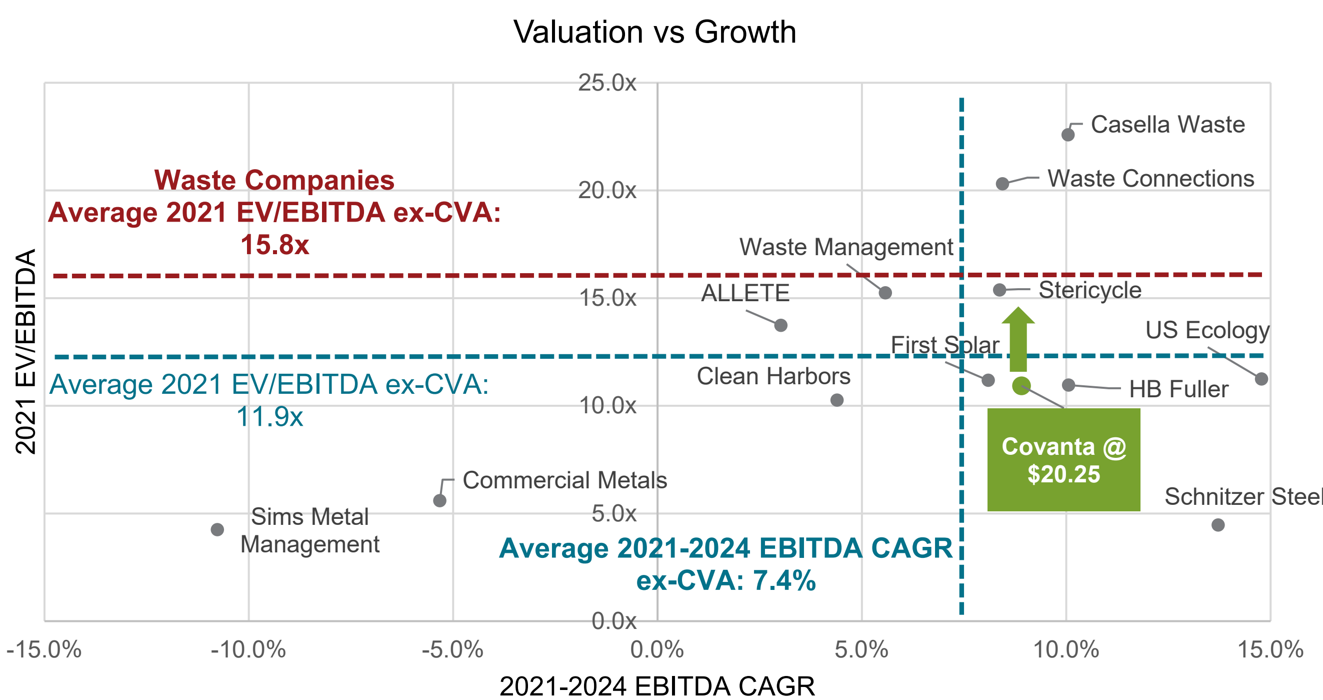
Considering Covanta's meaningfully stronger performance this year, the conservative assumptions underpinning the Covanta 2024 targets, and the low valuation multiple applied too early in the company's transformation, we believe that the current offer to shareholders is inappropriate. Our analysis indicates that the offer would need to increase to $26.00 to approach a fairer valuation based on conservative assumptions and $36.00 based on assumptions in line with current trends discussed above.

Sincerely,

Jean-Hugues de Lamaze
Director
Ecofin Advisors Limited

Michel Sznajer
Portfolio Manager
Ecofin Advisors Limited

Exhibit 1: Valuation and Growth



Note: Using 2021-2023 EBITDA CAGR for companies without a 2024 EBITDA consensus