

COVANTA HOLDING CORP

Form 10-Q

July 22, 2009

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**Form 10-Q**

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**For the quarterly period ended June 30, 2009**
- or**
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**For the transition period from            to**

**Commission file number 1-06732**

**COVANTA HOLDING CORPORATION**

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

**Delaware**

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

**95-6021257**

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

**40 Lane Road, Fairfield, NJ**

*(Address of Principal Executive Office)*

**07004**

*(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  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

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

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

**Applicable Only to Corporate Issuers:**

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

<b>Class</b>	<b>Outstanding at July 16, 2009</b>
Common Stock, \$0.10 par value	154,989,004 shares

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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES**  
**FORM 10-Q QUARTERLY REPORT**  
**For the Quarter Ended June 30, 2009**

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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, 2008 and in other filings by Covanta with the SEC.

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008 (As Adjusted)	2009	2008 (As Adjusted)
	(Unaudited)			
	(In thousands, except per share amounts)			
<b>OPERATING REVENUES:</b>				
Waste and service revenues	\$ 227,842	\$ 242,689	\$ 434,111	\$ 460,312
Electricity and steam sales	136,540	163,832	278,409	316,897
Other operating revenues	11,404	16,475	22,026	34,553
Total operating revenues	375,786	422,996	734,546	811,762
<b>OPERATING EXPENSES:</b>				
Plant operating expenses	214,556	238,608	470,598	497,619
Depreciation and amortization expense	51,162	51,590	102,660	100,164
Net interest expense on project debt	12,108	13,776	24,877	27,537
General and administrative expenses	26,906	23,135	52,421	47,289
Other operating expenses	9,722	19,358	19,466	31,859
Total operating expenses	314,454	346,467	670,022	704,468
Operating income	61,332	76,529	64,524	107,294
<b>Other income (expense):</b>				
Investment income	1,156	1,052	2,184	2,692
Interest expense	(8,532)	(11,563)	(16,448)	(25,283)
Non-cash convertible debt related expense	(6,395)	(4,453)	(11,097)	(8,827)
Total other expenses	(13,771)	(14,964)	(25,361)	(31,418)
Income before income tax expense, equity in net income from unconsolidated investments and noncontrolling interests in subsidiaries	47,561	61,565	39,163	75,876
Income tax expense	(17,901)	(24,361)	(14,583)	(30,032)
Equity in net income from unconsolidated investments	5,671	7,320	11,480	12,812

<b>NET INCOME</b>	35,331	44,524	36,060	58,656
Less: Net income attributable to noncontrolling interests in subsidiaries	(2,164)	(2,225)	(3,544)	(4,094)
<b>NET INCOME ATTRIBUTABLE TO COVANTA HOLDING CORPORATION</b>	<b>\$ 33,167</b>	<b>\$ 42,299</b>	<b>\$ 32,516</b>	<b>\$ 54,562</b>
<b>Weighted Average Common Shares Outstanding:</b>				
Basic	153,731	153,387	153,600	153,276
Diluted	154,953	154,848	154,846	154,710
<b>Earnings Per Share:</b>				
Basic	\$ 0.22	\$ 0.28	\$ 0.21	\$ 0.36
Diluted	\$ 0.21	\$ 0.27	\$ 0.21	\$ 0.35

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**

	<b>June 30, 2009 (Unaudited)</b>	<b>As of December 31, 2008</b>
	<b>(In thousands, except per share amounts)</b>	
<b>ASSETS</b>		
<b>Current:</b>		
Cash and cash equivalents	\$ 551,166	\$ 192,393
Marketable securities available for sale	300	300
Restricted funds held in trust	139,207	175,093
Receivables (less allowances of \$3,419 and \$3,437)	246,210	243,791
Unbilled service receivables	49,123	49,468
Deferred income taxes	36,350	
Prepaid expenses and other current assets	124,257	123,214
<b>Total Current Assets</b>	<b>1,146,613</b>	<b>784,259</b>
Property, plant and equipment, net	2,497,055	2,530,035
Investments in fixed maturities at market (cost: \$26,612 and \$26,620, respectively)	27,112	26,737
Restricted funds held in trust	139,675	149,818
Unbilled service receivables	35,051	44,298
Waste, service and energy contracts, net	200,479	223,397
Other intangible assets, net	86,614	83,331
Goodwill	202,996	195,617
Investments in investees and joint ventures	117,284	102,953
Other assets	291,303	139,544
<b>Total Assets</b>	<b>\$ 4,744,182</b>	<b>\$ 4,279,989</b>
<b>LIABILITIES AND EQUITY</b>		
<b>Current:</b>		
Current portion of long-term debt	\$ 6,639	\$ 6,922
Current portion of project debt	179,901	198,034
Accounts payable	27,414	24,470
Deferred revenue	13,565	15,202
Accrued expenses and other current liabilities	175,614	215,046
<b>Total Current Liabilities</b>	<b>403,133</b>	<b>459,674</b>
Long-term debt	1,416,767	941,596
Project debt	779,857	880,336
Deferred income taxes	553,194	493,919
Waste and service contracts	107,970	114,532
Other liabilities	163,236	165,881

<b>Total Liabilities</b>	3,424,157	3,055,938
<b>Commitments and Contingencies (Note 14)</b>		
<b>Equity:</b>		
Covanta Holding Corporation 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 155,561 and 154,797 shares; outstanding 154,889 and 154,280 shares)	15,556	15,480
Additional paid-in capital	892,273	832,595
Accumulated other comprehensive loss	(3,452)	(8,205)
Accumulated earnings	381,735	349,219
Treasury stock, at par	(67)	(52)
<b>Total Covanta Holding Corporation stockholders' equity</b>	<b>1,286,045</b>	<b>1,189,037</b>
Noncontrolling interests in subsidiaries	33,980	35,014
<b>Total Equity</b>	<b>1,320,025</b>	<b>1,224,051</b>
<b>Total Liabilities and Equity</b>	<b>\$ 4,744,182</b>	<b>\$ 4,279,989</b>

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

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

	<b>For the Six Months Ended</b> <b>June 30,</b> <b>2009</b> <b>2008</b> <b>(As Adjusted)</b> <b>(Unaudited)</b> <b>(In thousands)</b>	
<b>OPERATING ACTIVITIES:</b>		
Net income	\$ 36,060	\$ 58,656
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense	102,660	100,164
Amortization of long-term debt deferred financing costs	2,074	1,856
Amortization of debt premium and discount	(4,382)	(5,547)
Non-cash convertible debt related expense	11,097	8,827
Stock-based compensation expense	7,669	8,061
Equity in net income from unconsolidated investments	(11,480)	(12,812)
Dividends from unconsolidated investments	2,566	15,668
Deferred income taxes	4,997	12,599
Other, net	2,332	6,606
Decrease (increase) in restricted funds held in trust	6,654	(14,018)
Change in working capital, net of effects of acquisitions	(22,925)	(18,709)
Net cash provided by operating activities	137,322	161,351
<b>INVESTING ACTIVITIES:</b>		
Proceeds from the sale of investment securities	4,596	18,177
Purchase of investment securities	(5,544)	(11,106)
Purchase of property, plant and equipment	(42,098)	(53,764)
Purchase of equity interest	(8,938)	(18,503)
Acquisition of businesses, net of cash acquired	(17,517)	(20,128)
Loan issued to client community to fund certain facility improvements	(7,646)	(1,000)
Property insurance proceeds		6,315
Other, net	422	(146)
Net cash used in investing activities	(76,725)	(80,155)
<b>FINANCING ACTIVITIES:</b>		
Proceeds from borrowings on long-term debt	460,000	
Proceeds from issuance of warrants	53,958	
Purchase of convertible note hedge	(112,378)	
Payment of long-term debt deferred financing costs	(12,650)	
Proceeds from borrowings on project debt	2	4,102
Principal payments on long-term debt	(3,345)	(3,361)
Principal payments on project debt	(115,458)	(65,164)
Decrease (increase) in restricted funds held in trust	39,856	(12,148)

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Proceeds from the exercise of options for common stock, net	147	221
Financings of insurance premiums, net	(6,259)	(6,911)
Distributions to partners of noncontrolling interests in subsidiaries	(6,085)	(3,746)
Net cash provided by (used in) financing activities	297,788	(87,007)
Effect of exchange rate changes on cash and cash equivalents	388	111
Net increase (decrease) in cash and cash equivalents	358,773	(5,700)
Cash and cash equivalents at beginning of period	192,393	149,406
Cash and cash equivalents at end of period	\$ 551,166	\$ 143,706

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

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**COVANTA HOLDING CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF EQUITY**

**Covanta Holding Corporation Stockholders' Equity**

	Common Stock		Additional Paid-In Capital	Other Comprehensive Loss (Unaudited, In thousands)	Accumulated Earnings	Treasury Stock		Noncontrolling Interests in Subsidiaries	Total
	Shares	Amount				Shares	Amount		
Balance as of December 31, 2008 (As Adjusted)	154,797	\$ 15,480	\$ 832,595	\$ (8,205)	\$ 349,219	517	\$ (52)	\$ 35,014	\$ 1,224,051
Stock-based compensation expense			7,669						7,669
Issuance of Warrants			53,846						53,846
Shares forfeited for terminated employees			1			15	(1)		
Shares repurchased for tax withholdings for vested stock awards			(1,909)			140	(14)		(1,923)
Exercise of options to purchase common stock	25	3	144						147
Shares issued in non-vested stock award	739	73	(73)						
Distributions to partners of noncontrolling interests in subsidiaries								(6,085)	(6,085)
Comprehensive income, net of income taxes:									
Net income					32,516			3,544	36,060
Foreign currency translation				4,348				1,507	5,855
SFAS 158 unrecognized net				(84)					(84)

loss									
Net unrealized gain on available-for-sale securities				489					489
Total comprehensive income				4,753	32,516			5,051	42,320
Balance as of June 30, 2009	155,561	\$ 15,556	\$ 892,273	\$ (3,452)	\$ 381,735	672	\$ (67)	\$ 33,980	\$ 1,320,025

**Covanta Holding Corporation Stockholders Equity**  
**Accumulated**

**Additional Other Treasury Noncontrolling**  
**Common Stock Paid-In Comprehensive Accumulated Stock Interests**  
**Shares Amount Capital Income Earnings Shares Amount Subsidiaries**  
**Total**  
**(Unaudited, In thousands)**

Balance as of December 31, 2007 (As Adjusted)	154,281	\$ 15,428	\$ 821,338	\$ 16,304	\$ 220,259	359	\$ (36)	\$ 40,773	\$ 1,114,066
Stock-based compensation expense			8,061						8,061
Shares forfeited for terminated employees			1			12	(1)		
Shares repurchased for tax withholdings for vested stock awards			(3,706)			137	(14)		(3,720)
Exercise of options to purchase common stock	16	2	220						222
Shares issued in non-vested stock award	491	49	(49)						
Distributions to partners of noncontrolling interests in subsidiaries								(3,746)	(3,746)

Comprehensive (loss) income, net of income taxes:									
Net income					54,562			4,094	58,656
Foreign currency translation				(1,254)				(1,852)	(3,106)
SFAS 158 unrecognized net loss				(339)					(339)
Net unrealized gain on available-for-sale securities				(372)					(372)
Total comprehensive (loss) income				(1,965)	54,562			2,242	54,839
Balance as of June 30, 2008	154,788	\$ 15,479	\$ 825,865	\$ 14,339	\$ 274,821	508	\$ (51)	\$ 39,269	\$ 1,169,722

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

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

**Note 1. Organization and Basis of Presentation**

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

**Organization**

We are 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 60 energy generation facilities, 50 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, a biomass procurement business, four landfills, which we use primarily for ash disposal, 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, 2009. This Form 10-Q should be read in conjunction with the Audited Consolidated Financial Statements and accompanying Notes to the Consolidated Financial Statements in our Form 8-K for the year ended December 31, 2008 filed on May 18, 2009.

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

All intercompany accounts and transactions have been eliminated. Significant events which occurred subsequent to June 30, 2009 but prior to July 22, 2009, the filing date of this report, have been disclosed in Note 15. Subsequent Events.



Effective January 1, 2009, we adopted the following pronouncements which require us to retrospectively restate previously disclosed condensed consolidated financial statements. Certain prior period amounts have thus been reclassified in the unaudited condensed consolidated financial statements to conform to the current period presentation.

We adopted Statement of Financial Accounting Standards ( SFAS ) No. 160, Noncontrolling Interests in Consolidated Financial Statements an amendment of Accounting Research Bulletin (ARB) No. 51 ( SFAS 160 ). SFAS 160 amends the accounting and reporting for noncontrolling interests in a consolidated subsidiary and the deconsolidation of a subsidiary. Under SFAS 160, we now report minority interests in

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

subsidiaries (now referred to as noncontrolling interests in subsidiaries) as a separate component of equity in our condensed consolidated financial statements and show both net income attributable to the noncontrolling interest and net income attributable to the controlling interest on the face of the condensed consolidated income statement. SFAS 160 applies prospectively, except for presentation and disclosure requirements, which are applied retrospectively.

We adopted Financial Accounting Standards Board (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). FSP APB 14-1 is effective for our \$373.8 million aggregate principal amount of 1.00% Senior Convertible Debentures (the Debentures) and requires retrospective application for all periods presented. The FSP requires the issuer of convertible debt instruments with cash settlement features to separately account for the liability (\$276.0 million as of the date of the issuance of the Debentures) and equity components (\$97.8 million as of the date of the issuance of the Debentures) of the instrument. The debt component was recognized at the present value of its cash flows discounted using a 7.25% discount rate, our borrowing rate at the date of the issuance of the Debentures for a similar debt instrument without the conversion feature. The equity component, recorded as additional paid-in capital, was \$56.1 million, which represents the difference between the proceeds from the issuance of the Debentures and the fair value of the liability, net of deferred taxes of \$41.7 million as of the date of the issuance of the Debentures. For additional information, see Note 6. Changes in Capitalization.

FSP APB 14-1 also requires accretion of the resultant debt discount over the expected life of the Debentures, which is February 1, 2007 to February 1, 2012, based on the first permitted redemption date of the Debentures. The condensed consolidated income statements were retrospectively modified compared to previously reported amounts as follows (in millions, except per share amounts):

	<b>Three Months Ended June 30, 2008</b>	<b>Six Months Ended June 30, 2008</b>
Additional pre-tax non-cash convertible debt related expense	\$ (4.5)	\$ (8.8)
Additional deferred tax benefit	1.9	3.7
Retrospective change in net income and retained earnings	\$ (2.6)	\$ (5.1)
Change to basic earnings per share	\$ (0.01)	\$ (0.03)
Change to diluted earnings per share	\$ (0.02)	\$ (0.04)

For the three and six months ended June 30, 2009, the additional pre-tax non-cash convertible debt related expense recognized in our condensed consolidated income statement related to the adoption of FSP APB 14-1 was \$4.8 million and \$9.5 million, respectively.

**Note 2. Recent Accounting Pronouncements**

In June 2009, the FASB issued SFAS No. 168, The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles a replacement of FASB Statement No. 162 ( SFAS 168 ). The FASB Accounting Standards Codification ( Codification ) will become the source of authoritative U.S. GAAP recognized by the FASB to be applied by nongovernmental entities. Rules and interpretive releases of the Securities and Exchange Commission ( SEC ) under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. The Codification will supersede all then-existing non-SEC accounting and reporting standards. SFAS 168 is effective for our financial statements issued for interim and annual periods commencing with the quarterly period ended September 30, 2009. In the FASB s view, the issuance of SFAS 168 and the Codification will not change GAAP, and therefore we do not expect the adoption of SFAS 168 to have an effect on our financial statements or disclosures.

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

In June 2009, the FASB issued SFAS No. 167, Amendments to FASB Interpretation No. 46(R) ( SFAS 167 ), which is a revision to FASB Interpretation No. 46(R), Consolidation of Variable Interest Entities . SFAS 167 changes how a company determines when an entity that is insufficiently capitalized or when an entity is not controlled through voting (or similar rights) should be consolidated. The determination of whether a company is required to consolidate an entity is based on, among other things, an entity s purpose and design and a company s ability to direct the activities of the entity that most significantly impact the entity s economic performance. SFAS 167 is effective for us on January 1, 2010. We do not expect the adoption of SFAS 167 to have a material impact on our consolidated financial statements and we are continuing to assess the potential effects of this pronouncement.

In June 2009, the FASB issued SFAS No. 166, Accounting for Transfers of Financial Assets ( SFAS 166 ), which is a revision to SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities . SFAS 166 requires more information about transfers of financial assets, including securitization transactions and risks related to transferred financial assets. SFAS 166 eliminates the concept of a qualifying special-purpose entity, changes the requirements for derecognizing financial assets, and requires additional disclosures. SFAS 166 is effective for us on January 1, 2010. We do not expect the adoption of SFAS 166 to have a material impact on our consolidated financial statements and we are continuing to assess the potential effects of this pronouncement.

In December 2008, the FASB issued FSP SFAS No. 132R-1, Employers Disclosures about Postretirement Benefit Plan Assets ( FSP SFAS 132R-1 ) which significantly expands the disclosures required by employers for postretirement plan assets. The FSP requires plan sponsors to provide extensive new disclosures about assets in defined benefit postretirement benefit plans as well as any concentrations of associated risks. In addition, the FSP requires new disclosures similar to those in SFAS No. 157, Fair Value Measurements ( SFAS 157 ), in terms of the three-level fair value hierarchy. The disclosure requirements are annual and do not apply to interim financial statements and are required by us in disclosures related to the year ended December 31, 2009. We do expect the adoption of FSP SFAS 132R-1 to result in additional annual financial reporting disclosures and we are continuing to assess the potential effects of this pronouncement.

**Note 3. Acquisitions, Business Development and Dispositions**

Acquisitions made prior to December 31, 2008 were accounted for in accordance with SFAS No. 141, Business Combinations ( SFAS 141 ). Effective January 1, 2009, all business combinations are accounted for in accordance with SFAS No. 141 (revised 2007), Business Combinations ( SFAS 141R ). In April 2009, the FASB issued FSP SFAS 141(R)-1, Accounting for Assets Acquired and Liabilities Assumed in a Business Combination that Arise from Contingencies ( FSP SFAS 141(R)-1 ). The FSP amends SFAS 141R to require that assets acquired and liabilities assumed in a business combination that arise from contingencies (referred to as pre-acquisition contingencies ) be recognized at fair value, in accordance with SFAS 157, if the fair value can be determined during the measurement period. If the fair value of a pre-acquisition contingency cannot be determined during the measurement period, the FSP requires that the contingency be recognized at the acquisition date in accordance with SFAS No. 5, Accounting for Contingencies , and FASB Interpretation No. 14, Reasonable Estimation of the Amount of a Loss , if it meets the criteria for recognition in that guidance. FSP SFAS 141(R)-1 has the same effective date as SFAS 141R, which was effective for us for business combinations for which the acquisition date is on or after January 1, 2009.

Our growth strategy includes the acquisition of waste and energy related businesses located in markets with significant growth opportunities and the development of new projects and expansion of existing projects. We will also

consider acquiring or developing new technologies and businesses that are complementary with our existing renewable energy and waste services business. Acquisitions are accounted for under the purchase method of accounting. The results of operations reflect the period of ownership of the acquired businesses, business development projects and dispositions. The acquisitions in the section below are not material to our condensed

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

consolidated financial statements individually or in the aggregate and therefore, disclosures of pro forma financial information have not been presented.

***Acquisitions and Business Development***

***Domestic***

***Detroit Michigan Energy-from-Waste Facility***

On June 30, 2009, our long-term operating contract with the Greater Detroit Resource Recovery Authority ( GDRRA ) to operate the 2,832 tons per day ( tpd ) energy-from-waste facility located in Detroit, Michigan (the Detroit Facility ) expired. Effective June 30, 2009, we entered into the following transactions, which extend our interest in the Detroit Facility:

We purchased an undivided 30% owner participant interest in the Detroit Facility and final working capital for total cash consideration of approximately \$7.9 million.

We entered into an operating and maintenance agreement with owners of the Detroit Facility, pursuant to which we will operate, maintain and provide certain other services for the owners at the Detroit Facility for a term of one year.

We entered into a waste disposal agreement with GDRRA pursuant to which we will dispose of the waste of the City of Detroit for a term of at least one year. The term of the waste disposal agreement will automatically renew for successive one-year terms unless either party provides advance written notice of termination in accordance with the provisions thereof. In addition, as an owner participant we have the right, on one or more occasions, to call upon GDRRA to deliver the waste of the City of Detroit to the Detroit Facility at market-based rates. The call right continues for the duration of the participation agreement, which expires in 2035.

We have not finalized negotiation of pricing for a new steam agreement for the Detroit Facility. Securing a steam agreement with appropriate pricing is important for the long-term economic viability of the Detroit Facility.

***Philadelphia Transfer Stations***

On May 1, 2009, we acquired two waste transfer stations with combined capacity of 4,500 tpd in Philadelphia, Pennsylvania for cash consideration of approximately \$17.5 million, subject to final working capital adjustments. The preliminary purchase price allocation, which includes \$5.9 million of identifiable intangible assets primarily related to customer relationships and goodwill of approximately \$1.3 million, is based on estimates and assumptions, any changes to which could affect the reported amounts of assets, liabilities and expenses resulting from this acquisition.

***Maine Biomass Energy Facilities***

On December 22, 2008, we acquired Indeck Maine Energy, LLC which owned and operated two biomass energy facilities. The two nearly identical facilities, located in West Enfield and Jonesboro, Maine, added a total of 49 gross megawatts ( MW ) to our renewable energy portfolio. We sell the electric output and renewable energy credits from

these facilities into the New England market. We acquired these two facilities for cash consideration of approximately \$53.4 million, net of cash acquired, inclusive of final working capital adjustments. There were no amounts allocated to goodwill or other intangible assets in the final purchase price allocation.

*Kent County, Michigan Energy-from-Waste Facility*

On December 4, 2008, we entered into a new tip fee contract with Kent County in Michigan which commenced on January 1, 2009 and extended the existing contract from 2010 to 2023. This contract is expected to supply waste utilizing most or all of the facility's capacity. Previously this was a service fee contract.

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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES  
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*Pasco County, Florida Energy-from-Waste Facility*

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

*Indianapolis Energy-from-Waste Facility*

On July 25, 2008, we entered into a new tip fee contract with the City of Indianapolis for a term of 10 years which commenced upon expiration of the existing service fee contract in December 2008. This contract represents approximately 50% of the facility's capacity.

*Tulsa Energy-from-Waste Facility*

On June 2, 2008, we acquired an energy-from-waste facility in Tulsa, Oklahoma for cash consideration of approximately \$12.7 million. The design capacity of the facility is 1,125 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 returned two of the facility's three boilers to service in November 2008. Since the acquisition of this energy-from-waste facility, we have invested approximately \$5.3 million in capital improvements to restore its operational performance.

*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.

*Alternative Energy Technology Development*

We have entered into various agreements with multiple partners to invest in the development, testing or licensing of new technologies related to the transformation of waste materials into renewable fuels or the generation of energy. Initial licensing fees and demonstration unit purchases approximated \$6.5 million and \$1.4 million during the year ended December 31, 2008 and six months ended June 30, 2009, respectively.

*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. We have advanced \$15.9 million as of June 30, 2009 under this funding arrangement. The facility improvements are expected to be completed in the second half of 2009. On July 1, 2009, the first repayment installment on the advance was due but not paid. We are pursuing efforts to collect the past due amount, and to ensure that other amounts we have advanced will be repaid when due.

*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. In 2005, we entered into agreements with Hillsborough County to implement an expansion of this energy-from-waste facility, and to extend the agreement under which we operate the facility through 2027. Completion of the expansion, and commencement of the operation of the expanded project, is expected in the second half of 2009.

***International***

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

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 metric tpd energy-from-waste facility for Chengdu Municipality, in Sichuan Province, People's 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

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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES  
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venture company. The joint venture has obtained project financing for Rmb 480 million for the project, which we expect to be 49% guaranteed by us and 51% guaranteed by Chongqing Iron & Steel Company (Group) Limited until the project has been constructed and for one year after operations commence. The Chengdu project is expected to commence construction in the third quarter of 2009.

In December 2008, we entered into an agreement with Beijing Baoluo Investment Co., Ltd. ( Beijing Baoluo ) to purchase a direct 58% equity interest in the Fuzhou project, a 1,200 metric tpd 24 MW mass-burn energy-from-waste project in China for approximately \$14 million. We currently hold a noncontrolling interest in this project. This purchase was conditional upon various regulatory and other conditions precedent and was expected to close in the second quarter of 2009. Conditions required for closing were not achieved and Beijing Baoluo informed us that it no longer desired to proceed to closing the sale. We continue to hold a noncontrolling interest in this project.

On March 24, 2009, our joint venture Taixing Covanta Yanjiang Cogeneration Co., Ltd. of which we own 85%, entered into a 25 year concession agreement and waste supply agreements to build, own and operate a 350 metric tpd energy-from-waste facility for Taixing Municipality, in Jiangsu Province, People's Republic of China. The project, which will be built on the site of our existing coal-fired facility in Taixing, will supply steam to an adjacent industrial park under short-term arrangements. The Taixing project is expected to commence construction in the second half of 2009 and be completed in 2011.

*Dublin Joint Venture*

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 we control and co-own with DONG Energy Generation A/S. Project construction, which is expected to start in the second half of 2009, is estimated to cost approximately 350 million and is expected to require 36 months to complete, once full construction commences. 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 utilize debt financing for the project. The primary approvals and licenses for the project have been obtained, and any remaining consents, approvals and conditions necessary to begin full construction are expected to be obtained in due course. We have begun to perform preliminary on-site work and expect to commence full construction in the second half of 2009.

*Dispositions International*

In April 2009, we entered into agreements to terminate our joint venture with Guangzhou Development Power Investment Co., Ltd. ( GDPI ) and to sell our 40% equity interest in the joint venture entity, Guangzhou Development Covanta Environmental Energy Co., Ltd., at book value to an affiliate of GDPI for approximately \$1.2 million. The termination and sale are conditional upon various regulatory and other conditions precedent and is expected to close later this year. Notwithstanding the termination and sale, we intend to continue to cooperate with GDPI on the development of energy-from-waste projects in Guangdong Province, People's Republic of China on a project by project basis.



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

**Note 4. Earnings Per Share**

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

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
Net income attributable to Covanta Holding Corporation	\$ 33,167	\$ 42,299	\$ 32,516	\$ 54,562
<b>Basic earnings per share:</b>				
Weighted average basic common shares outstanding	153,731	153,387	153,600	153,276
Basic earnings per share	\$ 0.22	\$ 0.28	\$ 0.21	\$ 0.36
<b>Diluted earnings per share:</b>				
Weighted average basic common shares outstanding	153,731	153,387	153,600	153,276
Dilutive effect of stock options	412	745	433	682
Dilutive effect of restricted stock	810	716	813	752
Dilutive effect of convertible debentures				
Dilutive effect of warrants				
Weighted average diluted common shares outstanding	154,953	154,848	154,846	154,710
Diluted earnings per share	\$ 0.21	\$ 0.27	\$ 0.21	\$ 0.35
Stock options excluded from the weighted average dilutive common shares outstanding because their inclusion would have been antidilutive	1,981	300	1,981	300
Restricted stock awards excluded from the weighted average dilutive common shares outstanding because their inclusion would have been antidilutive				

See Note 1. Organization and Basis of Presentation for a discussion of the retrospective accounting change resulting from the adoption of FSP APB 14-1 effective January 1, 2009.

On May 22, 2009, we entered into privately negotiated warrant transactions in connection with the issuance of 3.25% Cash Convertible Senior Notes due 2014. These warrants could have a dilutive effect to the extent that the price of our common stock exceeds the applicable strike price of the warrants. As of June 30, 2009, the warrants did not have a dilutive effect on earnings per share. See Note 6. Changes in Capitalization.

On January 31, 2007, we issued 1.00% Senior Convertible Debentures due 2027. 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 June 30, 2009, the Debentures did not have a dilutive effect on earnings per share.

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

**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		All Other(1)	Total
	Domestic	International		
<b>Three Months Ended June 30, 2009:</b>				
Operating revenues	\$ 329,455	\$ 41,506	\$ 4,825	\$ 375,786
Operating income (loss)	59,804	2,039	(511)	61,332
<b>Three Months Ended June 30, 2008:</b>				
Operating revenues	\$ 350,729	\$ 69,152	\$ 3,115	\$ 422,996
Operating income (loss)	73,553	3,506	(530)	76,529
<b>Six Months Ended June 30, 2009:</b>				
Operating revenues	\$ 642,628	\$ 83,043	\$ 8,875	\$ 734,546
Operating income (loss)	64,239	1,180	(895)	64,524
<b>Six Months Ended June 30, 2008:</b>				
Operating revenues	\$ 674,013	\$ 131,931	\$ 5,818	\$ 811,762
Operating income (loss)	98,907	9,344	(957)	107,294

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

**Note 6. Changes in Capitalization****Short-Term Liquidity**

The credit facilities are 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). As of June 30, 2009, we were in compliance with all required covenants and had available credit for liquidity as follows (in thousands):

	Total Available Under Facility	Maturing	Outstanding Letters of Credit as of June 30, 2009	Available as of June 30, 2009
Revolving Loan Facility(1)	\$ 300,000	2013	\$	\$ 300,000
Funded L/C Facility	\$ 320,000	2014	\$ 283,031	\$ 36,969

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

In July 2009, the 6.8% pro rata commitment previously provided by Lehman Brothers Commercial Bank under the Revolving Loan Facility was assigned to another financial institution.

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

**Long-Term Debt**

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

	<b>June 30, 2009</b>	<b>As of December 31, 2008</b>
3.25% Cash Convertible Senior Notes due 2014	\$ 460,000	\$
Debt discount related to Cash Convertible Senior Notes	(122,206)	
Cash conversion option derivative at fair value	130,951	
3.25% Cash Convertible Senior Notes, net	468,745	
1.00% Senior Convertible Debentures due 2027	373,750	373,750
Debt discount related to Convertible Debentures	(54,880)	(64,369)
1.00% Senior Convertible Debentures, net	318,870	309,381
Term Loan Facility due 2014	635,375	638,625
Other long-term debt	416	512
Total	1,423,406	948,518
Less: current portion	(6,639)	(6,922)
Total long-term debt	\$ 1,416,767	\$ 941,596

***3.25% Cash Convertible Senior Notes due 2014***

On May 22, 2009, we issued \$400 million aggregate principal amount of 3.25% Cash Convertible Senior Notes (the Notes ) due 2014 in a private transaction exempt from registration under the Securities Act of 1933, as amended. On June 15, 2009, we issued an additional \$60 million aggregate principal amount of Notes upon exercise in full of an over-allotment option we granted as part of the private offering. We have used and will use the net proceeds from the offering, together with the proceeds from the warrant transactions discussed below, for general corporate purposes, which may include capital expenditures, potential permitted investments or permitted acquisitions.

The Notes constitute general unsecured senior obligations and rank equally in right of payment with our existing and future senior unsecured indebtedness. The Notes are effectively junior to our existing and future secured indebtedness to the extent of the value of the assets securing such indebtedness. The Notes are not guaranteed by any of our subsidiaries and are effectively subordinated to all existing and future indebtedness and liabilities (including trade payables) of our subsidiaries.



The Notes bear interest at a rate of 3.25% per year, payable semi-annually in arrears, on June 1 and December 1 of each year, commencing on December 1, 2009, and will mature on June 1, 2014. Under limited circumstances, we may be required to pay contingent interest on the Notes as a result of failure to comply with the reporting obligations in the indenture, failure to file required SEC documents and reports or if the holders cannot freely trade the Notes. When applicable, the contingent interest payable per \$1,000 principal amount of Notes ranges from 0.25% to 0.50% per annum over the applicable term as provided under the indenture for the Notes. The contingent interest features of the Notes are embedded derivative instruments. The fair value of the contingent interest features of the Notes was zero as of June 30, 2009.

Under limited circumstances described below, the Notes are convertible by the holders thereof into cash only, based on an initial conversion rate of 53.9185 shares of our common stock per \$1,000 principal amount of Notes (which represents an initial conversion price of approximately \$18.55 per share) subject to certain customary adjustments as provided in the indenture for the Notes. We will not deliver common stock (or any other securities)

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

upon conversion under any circumstances. Holders may convert their Notes only under the following circumstances:

prior to March 1, 2014, on any date during any fiscal quarter commencing at any time after June 30, 2009 and only during such fiscal quarter if the closing sale price of our common stock for at least 20 trading days during the period of 30 consecutive trading days ending on the last trading day of the immediately preceding fiscal quarter is greater than or equal to 130% of the then effective conversion price; or

upon the occurrence of specified corporate transactions (as provided in the indenture for the Notes); or

upon certain fundamental changes (as defined in the indenture for the Notes in which case the conversion rate will be increased as provided in the indenture); or

during the five consecutive business day period following any five consecutive trading-day period in which the trading price for the Notes for each day during such five-day period was less than 95% of the product of the closing sale price of our common stock on such day multiplied by the then effective conversion rate; or

at any time on or after March 1, 2014.

The Notes are also subject to repurchase by us, at the holder's option, if a fundamental change occurs, for cash at a repurchase price equal to 100% of the principal amount of the Notes, plus accrued and unpaid interest (including contingent interest, if any).

The Notes are recognized as long-term debt in our condensed consolidated financial statements. The difference between the face value of the Notes (\$460.0 million as of the date of issuance of the Notes) and the amount recognized in the financial statements (\$335.6 million as of the date of the issuance of the Notes) is the debt discount (\$124.4 million as of the date of the issuance of the Notes) which is accreted to the Notes over its life and recognized as non-cash convertible debt related expense. For both the three and six months ended June 30, 2009, the pre-tax non-cash convertible debt related expense recognized in our condensed consolidated income statement related to the Notes was \$2.2 million.

The Notes are convertible into cash only, and therefore the cash conversion option that is part of the Notes is accounted for as a derivative under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS 133). The initial valuation of the cash conversion option (the Cash Conversion Option) is an embedded derivative of \$124.4 million, which is recognized as long-term debt in our condensed consolidated financial statements. The Cash Conversion Option is recorded at fair value quarterly with any change in fair value being recognized in our condensed consolidated income statement as non-cash convertible debt related expense. As of June 30, 2009, the fair value of the Cash Conversion Option was \$131.0 million. See Note 11. Financial Instruments and Note 12. Derivative Instruments for additional information regarding the Cash Conversion Option.

In connection with the Notes offering, we entered into privately negotiated cash convertible note hedge transactions (the Note Hedge) with affiliates of certain of the initial purchasers of the Notes (the Option Counterparties) that are expected to reduce our exposure to potential cash payments in excess of the principal amount of the Notes that may be required to be made by us upon the cash conversion of the Notes. The Note Hedge consisted of our purchase for \$112.4 million of cash settled call options on our common stock (initially correlating to the same number of shares as those initially underlying the Notes subject to generally similar customary adjustments) that have economic

characteristics similar to those of the Cash Conversion Option embedded in the Notes. The Note Hedge was recorded as a noncurrent asset in our condensed consolidated financial statements for \$112.4 million. The Note Hedge is also accounted for as a derivative instrument under SFAS 133 and as such, is recorded at fair value quarterly with any change in fair value being recognized in our condensed consolidated income statement as non-cash convertible debt related expense. As of June 30, 2009, the fair value of the Note Hedge was \$119.5 million. See Note 11. Financial Instruments and Note 12. Derivative Instruments for additional information regarding the Note Hedge.

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

We expect the gain or loss from the Note Hedge to substantially offset the gain or loss associated with changes to the valuation of the Cash Conversion Option. Accordingly, we do not expect there to be a material net impact to our condensed consolidated statement of income as a result of our issuing the Notes and entering into the Note Hedge transactions.

In connection with the Notes offering, we also sold warrants (the Warrants) to the Option Counterparties, in privately negotiated transactions, initially correlating to the same number of shares as those initially underlying the Notes, which could have a dilutive effect to the extent that the market price of our common stock exceeds the then effective strike price of the Warrants. The Warrants were sold for aggregate proceeds of \$54.0 million. The strike price of the Warrants is approximately \$25.74 per share and is subject to customary adjustments. The Warrants are exercisable only at expiration in equal tranches over 60 days beginning on September 2, 2014 and ending on November 26, 2014. The Warrants are only net share settled which means that, with respect to any exercise date, we will deliver to the Warrant holders a number of shares for each warrant equal to the excess (if any) of the volume weighted average price of the shares on the exercise date over the then effective strike price of the Warrants, divided by such volume weighted average price of the shares, with a cash payment in lieu of fractional shares. Accordingly, the Warrants have been recorded as additional paid-in capital in our condensed consolidated financial statements for \$54.0 million. The Warrant transactions also meet the definition of a derivative under SFAS 133. However, because the Warrant transactions are indexed to our common stock and are recorded in equity in our condensed consolidated balance sheets, the Warrant transactions are exempt from the scope of SFAS 133 and will not be subject to the fair value provisions of SFAS 133.

Net proceeds from the above transactions were \$388.9 million, consisting of gross proceeds of \$460.0 million from the Notes and \$54.0 million of proceeds from the Warrants, less the \$112.4 million purchase price for the Note Hedge and \$12.7 million of purchase discounts and other offering expenses.

The Note Hedge transactions and the Warrant transactions are separate transactions, each of which we have entered into with the Option Counterparties, and are not part of the terms of the Notes and will not affect any rights of holders under the Notes. Holders of the Notes do not have any rights with respect to the Note Hedge transactions or Warrant transactions.

***1.00% Senior Convertible Debentures due 2027***

See Note 1. Organization and Basis of Presentation for a discussion of the liability component associated with the Debentures and the retrospective accounting change resulting from the adoption of FSP APB 14-1 effective January 1, 2009.

Under limited circumstances, prior to February 1, 2025, the Debentures are convertible by the holders into cash and shares of our common stock, if any, initially based on a conversion rate of 35.4610 shares of our common stock per \$1,000 principal amount of Debentures, (which represents an initial conversion price of approximately \$28.20 per share) or 13,253,867 issuable shares. As of June 30, 2009, if the Debentures were converted, no shares would have been issued since the trading price of our common stock was below the conversion price of the Debentures.

For specific criteria related to contingent interest, conversion or redemption features of the Debentures, refer to Note 6 of the Notes to Consolidated Financial Statements in our Form 8-K for the year ended December 31, 2008 filed on May 18, 2009.

**Debt discount for the Debentures and the Notes**

The debt discount related to the Debentures and the debt discount related to the Notes is accreted over their respective terms and recognized as non-cash convertible debt related expense. The accretion of debt discount

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

expected to be included in our condensed consolidated financial statements is as follows for each of the periods indicated (in millions):

	<b>2009</b>	<b>2010</b>	<b>For the Years Ended</b>		<b>2013</b>	<b>2014</b>
			<b>2011</b>	<b>2012</b>		
Pre-tax increase in non-cash convertible debt related expense for the Debentures	\$ 19.3	\$ 20.8	\$ 22.3	\$ 1.9	\$	\$
Pre-tax increase in non-cash convertible debt related expense for the Notes	\$ 11.9	\$ 21.3	\$ 23.5	\$ 26.0	\$ 28.8	\$ 12.9

**Equity**

During the six months ended June 30, 2009, we awarded grants for 739,712 shares of restricted stock awards. See Note 10. Stock-Based Compensation.

During the six months ended June 30, 2009, we did not repurchase shares of our common stock under the repurchase program authorized in September 2008.

See Note 1. Organization and Basis of Presentation for a discussion of the equity component associated with the Debentures and the retrospective accounting change resulting from the adoption of FSP APB 14-1 effective January 1, 2009.

**Note 7. Income Taxes**

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

We currently estimate our annual effective tax rate, including discrete items, for the year ended December 31, 2009 to be approximately 36.3%. We review the annual effective tax rate on a quarterly basis as projections are revised. The effective income tax rate was 37.2% and 39.6% for the six months ended June 30, 2009 and 2008, respectively. The liability for uncertain tax positions, exclusive of interest and penalties, was \$132.5 million as of both June 30, 2009 and December 31, 2008. No additional liabilities were recorded for uncertain tax positions during the six months ended June 30, 2009. Included in the balance of unrecognized tax benefits as of June 30, 2009 are potential benefits of \$114.9 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 both the three months ended June 30, 2009 and 2008, we recognized \$0.4 million and for the six months ended June 30, 2009 and 2008, we recognized \$0.4 million and \$0.7 million, respectively of interest and penalties on uncertain tax positions. As of June 30, 2009 and December 31, 2008, we had accrued interest and penalties associated with unrecognized tax benefits of \$8.4 million and \$8.1 million, respectively.

We will continue to monitor issues as they are examined by auditors representing tax authorities to determine whether an adjustment to existing FIN 48 liabilities is required or whether a FIN 48 liability should be provided for a new issue. 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 audits and adjust the liability as needed. Federal income tax returns for Covanta Energy are closed for the years through 2003. However, to the extent NOLs are utilized from earlier years, federal income tax returns for Covanta Holding Corporation, formerly known as Danielson Holding Corporation, are still open. The tax returns of our subsidiary ARC Holdings are open for federal audit for the tax return years of 2004 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

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

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 ). These Mission insurance entities have been in state insolvency proceedings in California and Missouri since the late 1980 s. The amount of NOLs available to us will be reduced by any taxable income or increased by any taxable losses generated by current members of our consolidated tax group, which include grantor trusts associated with the Mission insurance entities.

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

We had consolidated federal NOLs estimated to be approximately \$591 million for federal income tax purposes as of December 31, 2008, based on the tax returns as filed. The NOLs will expire in various amounts from December 31, 2009 through December 31, 2028, if not used. Current forecasts indicate we will utilize consolidated federal NOLs in 2009 which will otherwise expire in 2009. In addition to the consolidated federal NOLs, as of December 31, 2008, we had state NOL carryforwards of \$119.7 million, which expire between 2012 and 2027, capital loss carryforwards of \$69.0 million expiring in 2009, additional federal credit carryforwards of \$32.7 million, and state credit carryforwards of \$0.8 million. These deferred tax assets are offset by a valuation allowance of \$34.3 million.

For further information, refer to Note 9. Income Taxes of the Notes to the Consolidated Financial Statements included in our Form 8-K for the year ended December 31, 2008 filed on May 18, 2009.

**Note 8. Supplementary Information****Operating Revenues**

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

	<b>For the Three Months</b>		<b>For the Six Months</b>	
	<b>Ended June 30,</b>		<b>Ended June 30,</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
Waste and service revenues unrelated to project debt	\$ 208,529	\$ 218,965	\$ 395,209	\$ 412,829
Revenue earned explicitly to service project debt-principal	13,720	17,167	27,439	34,364
Revenue earned explicitly to service project debt-interest	5,593	6,557	11,463	13,119
Total waste and service revenues	\$ 227,842	\$ 242,689	\$ 434,111	\$ 460,312



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,

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

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 \$31.3 million and \$59.0 million for the three months ended June 30, 2009 and 2008, respectively, and \$63.6 million and \$113.1 million for the six months ended June 30, 2009 and 2008, 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 \$14.8 million and \$14.3 million for the three months ended June 30, 2009 and 2008, respectively, and \$29.6 million and \$30.2 million for the six months ended June 30, 2009 and 2008, 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 June 30, 2009 included or expected to be included in our condensed consolidated statement of income for each of the years indicated (in thousands):

	<b>Waste, Service and Energy Contracts (Amortization Expense)</b>	<b>Waste and Service Contracts (Contra-Expense)</b>
Six Months ended June 30, 2009	\$ 22,918	\$ (6,562)
Remainder of 2009	\$ 19,384	\$ (6,616)
2010	29,864	(12,721)
2011	26,740	(12,408)
2012	24,647	(12,412)
2013	21,037	(12,390)
2014	20,319	(12,390)

Thereafter		58,488		(39,033)
Total		\$ 200,479	\$	(107,970)

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

*Other operating expenses*

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

	<b>Other Operating Expenses</b>			
	<b>For the Three</b>		<b>For the Six Months</b>	
	<b>Months</b>		<b>Ended June 30,</b>	
	<b>Ended June 30,</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
Construction costs	\$ 5,979	\$ 12,110	\$ 11,325	\$ 25,267
Insurance subsidiary operating expenses	4,689	3,417	8,502	5,788
Insurance recoveries	(82)	(21)	(82)	(3,769)
Foreign exchange (gain) loss	(811)	493	(306)	(4)
Other	(53)	3,359	27	4,577
<b>Total other operating expenses</b>	<b>\$ 9,722</b>	<b>\$ 19,358</b>	<b>\$ 19,466</b>	<b>\$ 31,859</b>

**Non-cash convertible debt related expense**

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

	<b>Non-Cash Convertible Debt Related Expense</b>			
	<b>For the Three Months</b>		<b>For the Six Months</b>	
	<b>Ended June 30,</b>		<b>Ended June 30,</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
Debt discount accretion related to the Debentures	\$ 4,787	\$ 4,453	\$ 9,489	\$ 8,827
Debt discount accretion related to the Notes	2,225		2,225	
Fair value changes related to the Note Hedge	(7,137)		(7,137)	
Fair value changes related to the Cash Conversion Option	6,520		6,520	
<b>Total non-cash convertible debt related expense</b>	<b>\$ 6,395</b>	<b>\$ 4,453</b>	<b>\$ 11,097</b>	<b>\$ 8,827</b>

**Comprehensive Income**

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

<b>Three Months Ended</b>	<b>Six Months Ended</b>
<b>June 30,</b>	<b>June 30,</b>

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	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
Comprehensive income, net of income taxes:				
Net income attributable to Covanta Holding Corporation	\$ 33,167	\$ 42,299	\$ 32,516	\$ 54,562
Foreign currency translation	6,149	(2,281)	4,348	(1,254)
SFAS 158 unrecognized net loss	(42)	(170)	(84)	(339)
Net unrealized gain (loss) on available-for-sale securities	773	(302)	489	(372)
Other comprehensive income (loss) attributable to Covanta Holding Corporation	6,880	(2,753)	4,753	(1,965)
Comprehensive income attributable to Covanta Holding Corporation	\$ 40,047	\$ 39,546	\$ 37,269	\$ 52,597
Net income attributable to noncontrolling interests in subsidiaries	\$ 2,164	\$ 2,225	\$ 3,544	\$ 4,094
Other comprehensive income (loss) Foreign currency translation	2,037	(1,812)	1,507	(1,852)
Comprehensive income attributable to noncontrolling interests in subsidiaries	\$ 4,201	\$ 413	\$ 5,051	\$ 2,242

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

See Note 1. Organization and Basis of Presentation for a discussion of the retrospective accounting change resulting from the adoption of FSP APB 14-1 and SFAS 160 effective January 1, 2009.

**Goodwill**

The following table details the changes in carrying value of goodwill (in thousands):

	<b>Total</b>
Balance as of December 31, 2008	\$ 195,617
Purchase price adjustment related to the ARC Holdings acquisition	6,060
Goodwill related to the Pennsylvania transfer stations acquisition	1,319
 Balance as of June 30, 2009	 \$ 202,996

We increased goodwill and current liabilities by \$6.1 million during the quarter ended June 30, 2009 to recognize a liability due to one of our municipal clients that should have been recognized in the purchase price allocation relating to the ARC Holdings acquisition of June 2005.

**Note 9. Benefit Obligations***Pension and Other Benefit Obligations*

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

	<b>Pension Benefits</b>				<b>Other Post-Retirement Benefits</b>			
	<b>For the Three Months Ended June 30,</b>		<b>For the Six Months Ended June 30,</b>		<b>For the Three Months Ended June 30,</b>		<b>For the Six Months Ended June 30,</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
Service cost	\$	\$	\$	\$	\$	\$	\$	\$
Interest cost	1,197	1,176	2,394	2,352	123	137	245	274
Expected return on plan assets	(975)	(1,182)	(1,950)	(2,364)				
Amortization of net prior service cost	19		38					
Amortization of actuarial gain	(46)	(131)	(92)	(262)	(38)	(39)	(75)	(77)
Net periodic benefit cost	\$ 195	\$ (137)	\$ 390	\$ (274)	\$ 85	\$ 98	\$ 170	\$ 197

***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 \$3.0 million and \$2.7 million for the three months ended June 30, 2009 and 2008, respectively, and \$7.4 million and \$6.9 million for the six months ended June 30, 2009 and 2008, respectively.

**Note 10. Stock-Based Compensation**

Compensation expense related to our stock-based awards totaled \$3.8 million and \$7.7 million during the three and six months ended June 30, 2009, respectively, and \$4.4 million and \$8.1 million during the three and six months ended June 30, 2008, respectively.

During the six months ended June 30, 2009, we awarded certain employees 694,712 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, 1,627 shares vest during March of 2009, 2010 and 2011 and the remaining awards vest during March of 2010, 2011 and 2012.

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

On May 7, 2009, in accordance with our existing program for annual director compensation, we awarded 45,000 restricted stock awards under the Directors Plan. We determined that the service vesting condition of the restricted stock awards granted to the directors on May 7, 2009 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.

As of June 30, 2009, we had approximately \$15.9 million and \$4.6 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 2.3 years for our unvested restricted stock awards and 2.9 years for our unvested stock options.

**Note 11. Financial Instruments**

**Fair Value Measurements**

For the quarter ended June 30, 2009, we adopted the following FSPs which are intended to provide additional application guidance and enhance disclosures regarding fair value measurements:

FSP SFAS No. 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* ( FSP SFAS 157-4 ), provides guidelines for making fair value measurements more consistent with the principles presented in SFAS No. 157, *Fair Value Measurements*. The FSP provides guidance to determine if there has been a significant decrease in the volume and level of activity for the asset or liability, and to estimate fair values, when transactions or quoted prices are not determinative of fair value. FSP SFAS 157-4 requires management to use judgment to determine whether a market is distressed or not orderly, even if there has been a significant decrease in the volume and level of activity for the asset or liability.

FSP SFAS No. 107-1 and APB No. 28-1, *Interim Disclosures about Fair Value of Financial Instruments* enhances consistency in financial reporting by increasing the frequency of fair value disclosures. The FSP requires disclosure in the notes to the financial statements of fair value of its financial instruments in interim and annual reporting periods, together with the related carrying amounts, methods and significant assumptions used to estimate fair value, and changes in methods and significant assumptions, if any.

The adoption of these FSPs had no impact on our condensed consolidated financial statements and resulted only in additional financial reporting disclosures.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

For cash and cash equivalents, restricted funds, and marketable securities, the carrying value of these amounts is a reasonable estimate of their fair value. The fair value of restricted funds held in trust is based on quoted market prices of the investments held by the trustee.

Fair values for debt were determined based on interest rates that are currently available to us for issuance of debt with similar terms and remaining maturities for debt issues that are not traded on quoted market prices.



The fair value of project debt is estimated based on quoted market prices for the same or similar issuances of debt.

Fair value of our interest rate swap agreement is the estimated amount we would receive or pay to terminate the agreement based on the net present value of the future cash flows as defined in the agreement.

Fair values of derivative instruments are determined using available market information and appropriate valuation methodologies. We recognize derivative instruments on the balance sheet at their fair value. The Cash Conversion Option is valued quarterly using a Black Scholes model incorporating our common stock closing price at the reporting date and an implied volatility factor for our common stock; to determine the

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

value of the Note Hedge, the Cash Conversion Option amount is then discounted at a discount rate reflecting the Option Counterparties' credit standing. The Option Counterparties are highly rated financial institutions, none of whom experienced any significant downgrades during the three months ending June 30, 2009 which could reduce any receivable amount owed to us. The contingent interest features related to the Debentures and the Notes are valued quarterly using the present value of expected cash flow models incorporating the probabilities of the contingent events occurring.

The estimated fair-value amounts have been determined using available market information and appropriate valuation methodologies. However, considerable judgment is necessarily required in interpreting market data to develop estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts that we would realize in a current market exchange. The fair-value estimates presented herein are based on pertinent information available to us as of June 30, 2009. However, such amounts have not been comprehensively revalued for purposes of these financial statements since June 30, 2009, and current estimates of fair value may differ significantly from the amounts presented herein.

The following tables presents information about our assets and liabilities and their fair value measurements as of June 30, 2009:

<b>Financial Instruments Recorded at Fair Value on a Recurring Basis:</b>	<b>As of June 30, 2009</b>		<b>Fair Value Measurements at Reporting Date Using</b>		
	<b>Carrying Amount</b>	<b>Estimated Fair Value (In thousands)</b>	<b>Quoted Prices in Active Markets for Identical Assets (Level 1)</b>	<b>Significant Other Observable Inputs (Level 2)</b>	<b>Significant Unobservable Inputs (Level 3)</b>
<b>Assets:</b>					
Cash and cash equivalents:					
Bank deposits and certificates of deposit	\$ 77,639	\$ 77,639	\$ 77,639	\$	\$
Money market funds	473,527	473,527	473,527		
Total cash and cash equivalents:	551,166	551,166	551,166		
Restricted funds held in trust:					
Bank deposits and certificates of deposit	61,045	61,045	61,045		
Money market funds	140,093	140,133	140,133		
U.S. Treasury/Agency obligations(a)	30,266	30,503	30,503		
State and municipal obligations	13,275	13,140	13,140		
Commercial paper/Guaranteed investment contracts/Repurchase agreements	54,595	54,731	54,731		

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Total restricted funds held in trust:	299,274	299,552	299,552		
Investments					
Marketable securities available for sale	300	300	300		
Investments held to maturity:					
U.S. Treasury/Agency obligations	14,700	14,700	14,700		
Residential mortgage-backed securities	4,031	4,031	4,031		
Corporate investments	8,381	8,381	8,381		
Equity securities	729	729	729		
Total investments:	28,141	28,141	28,141		
Interest rate swap receivable	10,825	10,825		10,825	
Derivative Asset Note Hedge	119,515	119,515		119,515	
Total assets:	\$ 1,008,921	\$ 1,009,199	\$ 878,859	\$ 130,340	\$
<b>Liabilities:</b>					
Derivative Liability Cash Conversion Option	\$ 130,951	\$ 130,951	\$	\$ 130,951	\$
Derivative Liabilities Contingent interest features of the Debentures and Notes	0	0		0	
Interest rate swap payable	10,825	10,825		10,825	
Total liabilities:	\$ 141,776	\$ 141,776	\$	\$ 141,776	\$

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

<b>Financial Instruments Recorded at Carrying Amount:</b>	<b>Carrying Amount</b>	<b>Estimated Fair Value</b>
<b>Assets:</b>		
Accounts receivables	\$ 269,497	\$ 269,497
<b>Liabilities:</b>		
Long-term debt (excluding Cash Conversion Option)	\$ 1,292,455	\$ 1,223,699
Project debt	\$ 959,758	\$ 947,525
<b>Equity:</b>		
Warrants	\$ 53,846	\$ 75,157

(a) The U.S. Treasury/Agency obligations in restricted funds held in trust are primarily comprised of Federal Home Loan Mortgage Corporation securities at fair value.

**Investments**

For the quarter ended June 30, 2009, we adopted FSP SFAS No. 115-2 and SFAS No. 124-2, Recognition and Presentation of Other-Than-Temporary Impairments, which provides additional guidance designed to create greater clarity and consistency in accounting for and presenting impairment losses on securities. The FSP revises recognition guidance in determining whether a debt security is other-than-temporarily impaired. A debt security is considered other-than-temporarily impaired if the fair value is less than the amortized cost, and in any of the following circumstances: an entity has the intent to sell the security, or it is more likely than not that an entity will be required to sell the security prior to the recovery of its amortized cost basis; and an entity does not expect to recover the entire amortized cost basis of the security. The FSP provides further guidance to determine the amount of impairment to be recorded in earnings and/or other comprehensive income. The adoption of these FSPs did not have a material impact on our consolidated financial statements and resulted primarily in additional financial reporting disclosures.

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

Other-than-temporary declines in fair value are recorded as realized losses in the condensed consolidated statements of income and the cost basis of the security is reduced. We consider the following factors in determining whether declines in the fair value of securities are other-than-temporary :

the significance of the decline in fair value compared to the cost basis;

the time period during which there has been a significant decline in fair value;

whether the unrealized loss is credit-driven or a result of changes in market interest rates;

a fundamental analysis of the business prospects and financial condition of the issuer; and

our ability and intent to hold the investment for a period of time sufficient to allow for any anticipated recovery in fair value.

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

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

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

	Cost or Amortized Cost	As of June 30, 2009		Fair Value
		Unrealized Gain	Unrealized Loss	
<b>Current investments:</b>				
Fixed maturities	\$ 300	\$	\$	\$ 300
Equity securities insurance business	732	50	53	729
<b>Total current investments</b>	<b>\$ 1,032</b>	<b>\$ 50</b>	<b>\$ 53</b>	<b>\$ 1,029</b>
<b>Noncurrent investments:</b>				
Fixed maturities insurance business:				
U.S. government obligations	\$ 565	\$ 12	\$	\$ 577
U.S. government agencies	13,774	349		14,123
Residential mortgage-backed	3,977	61	7	4,031
Corporate	8,296	135	50	8,381
Total fixed maturities insurance business	26,612	557	57	27,112
Investment at cost international business	3,437			3,437
Mutual and bond funds	1,539	97		1,636
<b>Total noncurrent investments</b>	<b>\$ 31,588</b>	<b>\$ 654</b>	<b>\$ 57</b>	<b>\$ 32,185</b>

	Cost or Amortized Cost	As of December 31, 2008		Fair Value
		Unrealized Gain	Unrealized Loss	
<b>Current investments:</b>				
Fixed maturities	\$ 300	\$	\$	\$ 300
Equity securities insurance business	760	62	30	792
<b>Total current investments</b>	<b>\$ 1,060</b>	<b>\$ 62</b>	<b>\$ 30</b>	<b>\$ 1,092</b>
<b>Noncurrent investments:</b>				
Fixed maturities insurance business:				
U.S. government obligations	\$ 565	\$ 22	\$	\$ 587
U.S. government agencies	17,332	307	19	17,620

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Residential mortgage-backed	4,183	27	26	4,184
Corporate	4,540		194	4,346
Total fixed maturities insurance business	26,620	356	239	26,737
Investment at cost international business	3,437			3,437
Mutual and bond funds	1,404		433	971
<b>Total noncurrent investments</b>	<b>\$ 31,461</b>	<b>\$ 356</b>	<b>\$ 672</b>	<b>\$ 31,145</b>

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

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

Description of Investments	As of June 30, 2009		As of December 31, 2008	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury and other direct U.S. Government obligations	\$	\$	\$ 2,841	\$ 19
Federal agency mortgage-backed securities	1,037	7	1,547	26
Corporate bonds	3,420	50	3,996	194
Total fixed maturities	4,457	57	8,384	239
Equity securities	402	53	307	30
Total temporarily impaired investments	\$ 4,859	\$ 110	\$ 8,691	\$ 269

The number of U.S. Treasury and federal agency obligations, mortgage-backed securities, and corporate bonds temporarily impaired are 0, 1, and 9, respectively. As of June 30, 2009, all of the temporarily impaired fixed maturity investments with a fair value of \$4.5 million had maturities greater than 12 months.

Our fixed maturities held by our insurance subsidiary include mortgage-backed securities and collateralized mortgage obligations, collectively ( MBS ) representing 14.9%, and 15.6% of the total fixed maturities as of June 30, 2009 and December 31, 2008, respectively. Our MBS holdings are issued by the Federal National Mortgage Association ( FNMA ), the Federal Home Loan Mortgage Corporation ( FHLMC ), or the Government National Mortgage Association ( GNMA ) all of which are rated AAA by Moody's Investors Services. MBS and callable bonds, in contrast to other bonds, are more sensitive to market value declines in a rising interest rate environment than to market value increases in a declining interest rate environment.

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

Available-for-sale:	As of June 30, 2009	
	Amortized Cost	Fair Value
One year or less	\$ 5,631	\$ 5,739
Over one year to five years	19,470	19,869
Over five years to ten years	1,511	1,504
More than ten years		



Total fixed maturities	\$	26,612	\$	27,112
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The following reflects the change in net unrealized gain (loss) on available-for-sale securities included as a separate component of accumulated AOCI in the condensed consolidated statements of equity (in thousands):

	<b>For the Three Months Ended June 30,</b>		<b>For the Six Months Ended June 30,</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
Fixed maturities, net	\$ 500	\$ (277)	\$ 412	\$ (177)
Equity securities, net	160	(10)	(20)	(69)
Mutual and bond funds	113	(15)	97	(126)
Change in net unrealized gain (loss) on investments	\$ 773	\$ (302)	\$ 489	\$ (372)

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

The components of net unrealized gain (loss) on available-for-sale securities consist of the following (in thousands):

	<b>For the Three Months Ended June 30, 2009</b>		<b>For the Six Months Ended June 30, 2009</b>	
Net unrealized holding gain (loss) on available-for-sale securities arising during the period	\$ 744	\$ (334)	\$ 460	\$ (404)
Reclassification adjustment for net realized losses on available-for-sale securities included in net income	29	32	29	32
Net unrealized gain (loss) on available-for-sale securities	\$ 773	\$ (302)	\$ 489	\$ (372)

**Note 12. Derivative Instruments**

Effective January 1, 2009, we adopted SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities – An Amendment of FASB Statement No. 133 ( SFAS 161 ). SFAS 161 establishes the disclosure requirements for derivative instruments and for hedging activities with the intent to provide financial statement users with an enhanced understanding of the entity's use of derivative instruments, the accounting of derivative instruments and related hedged items under SFAS 133 and its related interpretations, and the effects of these instruments on the entity's financial position, financial performance, and cash flows. Other than the enhanced disclosures as follows, the adoption of SFAS 161 had no impact on our condensed consolidated financial statements.

The following disclosures summarize the fair value of derivative instruments not designated as hedging instruments under SFAS 133 in the condensed consolidated balance sheets and the effect of changes in fair value related to those derivative instruments not designated as hedging instruments under SFAS 133 on the condensed consolidated statements of income.

**Derivative Instruments Not Designated**

<b>as Hedging Instruments under SFAS 133</b>	<b>Balance Sheet Location</b>	<b>Fair Value as of June 30, December 31, 2009 2008 (In thousands)</b>	
<b>Asset Derivatives:</b>			
Interest rate swap receivable	Other noncurrent assets	\$ 10,825	\$ 13,984
Note Hedge	Other noncurrent assets	\$ 119,515	\$
<b>Liability Derivatives:</b>			
Cash Conversion Option	Long-term debt	\$ 130,951	\$
Contingent interest features of the Debentures and Notes	Other noncurrent liabilities	\$ 0	\$ 0
Interest rate swap payable	Other noncurrent liabilities	\$ 10,825	\$ 13,984



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

<b>Effect on Income of Derivatives Instruments</b>	<b>Location of Gain or (Loss)</b>	<b>Amount of Gain or (Loss)</b>			
		<b>Recognized in Income on</b>			
<b>Not Designated as Hedging Instruments</b>	<b>Recognized in Income on</b>	<b>Derivative</b>			
		<b>For the</b>	<b>For</b>	<b>For the</b>	<b>For</b>
<b>under SFAS 133</b>	<b>Derivatives</b>	<b>Three</b>	<b>the</b>	<b>Six</b>	<b>Six</b>
		<b>Months</b>	<b>Months</b>	<b>Months</b>	<b>Months</b>
		<b>Ended</b>	<b>Ended</b>	<b>Ended</b>	<b>Ended</b>
		<b>June 30,</b>	<b>June 30,</b>	<b>June 30,</b>	<b>June 30,</b>
		<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
		<b>(In thousands)</b>			
Note Hedge	Non-cash convertible debt related expense	\$ 7,137	\$	\$ 7,137	\$
Cash Conversion Option	Non-cash convertible debt related expense	(6,520)		(6,520)	
Contingent interest features of the Debentures and Notes	Non-cash convertible debt related expense				
Interest rate swap	Net interest expense on project debt				
Effect on income of derivative instruments not designated as hedging instruments under SFAS 133		\$ 617	\$	\$ 617	\$

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

The Cash Conversion Option is a derivative instrument which is recorded at fair value quarterly with any change in fair value being recognized in our condensed consolidated income statement as non-cash convertible debt related expense. The fair value of the Cash Conversion Option was \$131.0 million as of June 30, 2009. The Note Hedge is accounted for as a derivative instrument under SFAS 133 and as such, is recorded at fair value quarterly with any change in fair value being recognized in our condensed consolidated income statement as non-cash convertible debt related expense. The fair value of the Note Hedge was \$119.5 million as of June 30, 2009. The contingent interest features of the Notes are embedded derivative instruments. The fair value of the contingent interest features of the Notes was zero as of June 30, 2009.

We expect the gain or loss from the Note Hedge to substantially offset the gain or loss associated with changes to the valuation of the Cash Conversion Option. Accordingly, we do not expect there to be a material net impact to our condensed consolidated statement of income as a result of our issuing the Notes and entering into the Note Hedge. Our most significant credit exposure arises from the Note Hedge of the Notes. The fair value of the Note Hedge reflects the maximum loss that would be incurred should the Option Counterparties fail to perform according to the terms of the Note Hedge agreement. The Option Counterparties are highly rated financial institutions and we believe that the credit risk associated with their non-performance is not significant. See Note 6. Changes in Capitalization for

specific details related to the Cash Conversion Option, Note Hedge and contingent interest features of the Notes.

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

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

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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 value for the embedded derivative was zero as of June 30, 2009.

***Interest Rate Swaps***

As of June 30, 2009, we had one interest rate swap agreement related to project debt that economically fixes the interest rate on certain adjustable-rate revenue bonds. This swap agreement was entered into in September 1995 and expires in January 2019. Any payments made or received under the swap agreement, including fair value amounts upon termination, are included as an explicit component of the client community's obligation under the related service agreement. Therefore, all payments made or received under the swap agreement are a pass through to the client community. Under the swap agreement, we pay a fixed rate of 5.18% and receive a floating rate that is either equal to (i) the rate on the adjustable rate revenue bonds or (ii) an alternative floating rate based on a percentage of LIBOR or the BMA Municipal Swap Index if certain triggering events occur, such as a put of bonds to the standby credit facility th