Covanta Holding Corporation (CVA)

Updated August 6th, 2020 by Felix Martinez

Key Metrics

Current Price:	$9.85	**5 Year CAGR Estimate:**	9.5%	**Market Cap:**	$1.3 B
Fair Value Price:	$8.10	**5 Year Growth Estimate:**	10.0 %	**Ex-Dividend Date:**	09/26/20[1]
% Fair Value:	122%	**5 Year Valuation Multiple Estimate:**	-3.8%	**Dividend Payment Date:**	10/04/20
Dividend Yield:	3.3%	**5 Year Price Target**	$13	**Years Of Dividend Growth:**	0
Dividend Risk Score:	F	**Retirement Suitability Score:**	C	**Last Dividend Increase:**	N/A

Overview & Current Events

Covanta Holding Corporation was originally called Ogden Corporation, a holding company for utility businesses' investments. Ogden Corporation was founded in 1939. In 2001, Ogden's name was changed to Covanta to represent its focus on energy. Covanta Holding Corp. is headquartered in Morristown, New Jersey. The company provides Waste-to-Energy (WtE) facilities that convert approximately 21 million tons of waste from municipalities and businesses into clean, renewable electricity to power one million homes and recycle 500,000 tons of metal. Covanta charges a fee for waste disposal, sells electricity produced in the process, and recovers metal for recycling. Most of the company revenue comes from the Waste and Service segment. The Waste and Service segment made up 74% of total revenue for the fiscal year (FY) 2019. The other significate segments are the Energy segment and the Recycled metals segment, which made up 17% and 6% of total sales, respectfully. In total, the company generated revenue of approximately $1,870 million in FY2019. The company's current market capitalization is $1.3 billion.

On July 20, 2020, the company reported second-quarter results. Covanta saw limited disruption during the COVID-19 economic shutdown as it is providing essential services. For the three months ending on June 30, the company saw revenues lower by (2.8)%, or from $467 million for 2Q19 to now $454 million. However, for the first six months of Fiscal Year (FY)2020, the company saw an uptick of 0.2% increase in revenue from $920 million to now $922 million. Operating income increased by 80%. This increase is because of the cost-saving that has been implemented by the company. For example, Plant operating expense was down from $354 million in 2Q19, to $340 million this quarter. Net income had a loss of $(13) million compared to a loss of $(21) in 2Q19. However, for the first half of FY2020, net income reported being $(45) million lost vs. $(16) million that was lost in the first half of FY2019.

On April 14, Covanta's management team decided to cut its dividend by 68%, from $0.25 per share per quarter to $0.08. The analyst consensus GAAP EPS estimates a loss of $0.41 for the full year 2020. Since GAAP earnings are expected to be negative for 2020, we will be using a normalized EPS of $0.54 – which is the average EPS from 2017 through 2019 – for our fair value calculations.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$0.40	$1.54	$0.86	-$0.05	-$0.02	$0.51	-$0.03	$0.44	$1.15	$0.08	***$0.54***	***$0.87***
DPS	$0.00	$0.30	$0.66	$0.86	$1.00	$1.00	$1.00	$1.00	$1.00	$1.00	***$0.49***	***$0.49***
Shares[2]	154.0	142.0	133.0	130.0	130.0	133.0	129.0	131.0	132.0	133.0	***133.0***	***133.0***

Covanta's future growth prospects will mostly come from expanding its customers base with service offerings and energy contracts. However, the biggest driver for growth would come from project development or acquisitions in selected attractive markets and through the development of new facilities. The past 10-year earnings growth rate has been both volatile and weak. This year and next year, earnings are expected to be negative.

[1] Ex-dividend date and dividend payment date are estimates.

[2] Share count is in millions.

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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Earnings should return to being positive in 2022. We expect earnings growth of 10% for the next five years. The main drivers for the growth will be the increased volumes of waste processed, metals recovered, and electricity sold and the impact of the operations of the New York City Marine Transfer Station. Covanta started paying out dividends in 2011 and grew them until 2015. We do not expect any dividend increase in the foreseeable future as the company will face negative earnings for the next few years.

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	42.9	8.9	21.4	---	---	30.4	---	38.6	11.6	197.3	***18.2***	***15.0***
Avg. Yld.	---	2.2%	3.3%	3.7%	3.9%	6.5%	6.4%	5.9%	7.5%	6.7%	***3.3%***	***3.8%***

There have been a few years where earnings were negative; thus, the PE ratio is very erratic. However, the 10-year PE average is 35.1. We do not think this is a reasonable ratio. We believe a PE of 15 is par with other companies in the industrial sector.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	0.0%	19.5%	76.7%	---	---	---	---	---	87.0%	---	***91%***	***56%***

The company’s earnings are very cyclical, and it showed in the 2008-2009 Great Recession. The company’s stock saw a maximum drawdown of 52.9%. EPS also declined from $0.90 in 2008 to $$0.66 in 2009, a 27% decrease. In 2010, earnings decreased $0.40, then rebounded to $1.54 in 2011 for an increase of 285%.

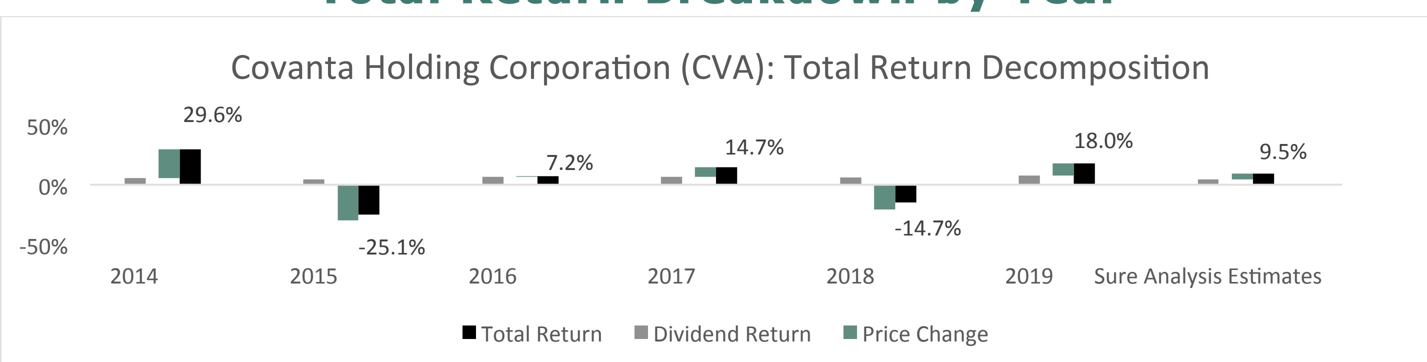
Covanta operates in an industry with high capital expenditures, which creates a barrier to entry; this is its competitive advantage.

Covanta is heavily leveraged, and its balance sheet looks to be stretched thin. The company only has an interest coverage ratio of 0.7 and a high debt to equity ratio of 9.1. S&P assigns a Credit Rating of B+ for Covanta, which is a “Highly Speculative” rating. The dividend payout ratio has seen years where it was over 100%. The high payout has led the company to cut the dividend earlier this year by 68%. There is a good chance the company will cut its dividend again as earnings are expected to be negative this year and next year.

Final Thoughts & Recommendation

Covanta is highly leveraged, and we only see an expected return of 9.5%, which is low for the risk involved with this speculative stock, we rate this company as a hold at the current price, and only for highly speculative investors.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	1583	1650	1643	1630	1682	1645	1699	1752	1868	1870
SG&A Exp.	103	84	78	82	97	93	100	112	115	122
D&A Exp.	190	193	194	209	211	198	207	215	218	221
Operating Profit	225	254	251	250	218	152	129	103	149	92
Operating Margin	14.2%	15.4%	15.3%	15.3%	13.0%	9.2%	7.6%	5.9%	8.0%	4.9%
Net Profit	62	219	116	-9	-2	68	-4	57	152	10
Net Margin	3.9%	13.3%	7.1%	-0.6%	-0.1%	4.1%	-0.2%	3.3%	8.1%	0.5%
Free Cash Flow	297	243	215	128	125	-122	-95	-35	32	68
Income Tax	24	35	31	43	15	-84	22	-191	-29	-7

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	4676	4385	4526	4380	4206	4234	4284	4441	3843	3715
Cash & Equivalents	126	232	243	195	84	94	84	46	58	37
Accounts Receivable	275	260	256	264	299	312	332	341	338	240
Goodwill & Int. Ass.	309	809	671	650	605	623	599	600	600	579
Total Liabilities	3517	3297	3471	3474	3422	3594	3815	4014	3356	3339
Accounts Payable	23	25	40	24	33	90	98	151	76	36
Long-Term Debt	2368	2166	2332	2321	2198	2461	2635	2523	2494	2516
Shareholder's Equity	1126	1083	1048	902	782	638	469	427	487	376
D/E Ratio	2.1	2.0	2.2	2.6	2.8	3.9	5.6	5.9	5.1	6.7

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	1.3%	4.8%	2.6%	-0.2%	0.0%	1.6%	-0.1%	1.3%	3.7%	0.3%
Return on Equity	4.9%	19.8%	10.9%	-0.9%	-0.2%	9.6%	-0.7%	12.7%	33.3%	2.3%
ROIC	1.7%	6.5%	3.5%	-0.3%	-0.1%	2.2%	-0.1%	1.9%	5.1%	0.3%
Shares Out.	154	142	133	130	130	133	129	131	132	133
Revenue/Share	$10.28	$11.62	$12.35	$12.54	$12.94	$12.37	$13.17	$13.37	$14.15	$14.06
FCF/Share	$1.93	$1.71	$1.62	$0.98	$0.96	-$0.92	-$0.74	-$0.27	$0.24	$0.51

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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