



Covanta Holding Corporation (CVA)

Updated June 5th, 2021 by Felix Martinez

Key Metrics

| | | | | | |
|-----------------------------|--------|--|--------|----------------------------------|----------|
| Current Price: | \$15 | 5 Year CAGR Estimate: | -6.7% | Market Cap: | \$2 B |
| Fair Value Price: | \$5.55 | 5 Year Growth Estimate: | 10.0% | Ex-Dividend Date: | 06/24/21 |
| % Fair Value: | 268% | 5 Year Valuation Multiple Estimate: | -17.9% | Dividend Payment Date: | 07/02/21 |
| Dividend Yield: | 2.4% | 5 Year Price Target | \$9 | Years Of Dividend Growth: | 0 |
| Dividend Risk Score: | F | Retirement Suitability Score: | F | 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) 2020. The other significant segments are the Energy segment and the Recycled metals segment, which made up 17% and 6% of total sales. In total, the Company generated revenue of approximately \$1,904 billion in FY2020. The Company's current market capitalization is \$2 billion.

On April 29, 2021, the Company reported first-quarter results for Fiscal Year (FY)2021. Covanta saw limited disruption during the COVID-19 economic shutdown as it is providing essential services. For the quarter. The Company saw revenues higher from \$468 million in the first quarter of 2020 to now \$498 million, or an increase of 6.4% year over year. CVA reported an operating income of \$14 million for the quarter compared to a loss of operating income of \$(12) million in 1Q20. Operating income coming in positive results from not impairment charges compared to a \$19 million impairment charge in 1Q20. Net income was \$2 million for the quarter, but a considerable improvement compared to a net income loss of \$(32) million in the first quarter of 2020.

On April 14, 2020, Covanta's management team decided to cut its dividend by 68%, from \$0.25 per share per quarter to \$0.08 per share. The management team still has not increased its dividend since April of last year.

Analyst consensus has a Generally accepted accounting principles (GAAP) earnings per share estimate at a loss for the full year 2021. Since GAAP earnings are expected to be negative for 2021, we will be using a normalized EPS of \$0.37 per share for our fair value calculations.

Growth on a Per-Share Basis

| Year | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2026 |
|---------------------------|--------|--------|----------|----------|--------|----------|--------|--------|--------|----------|---------------|---------------|
| EPS | \$1.54 | \$0.86 | (\$0.05) | (\$0.02) | \$0.51 | (\$0.03) | \$0.44 | \$1.15 | \$0.08 | (\$0.21) | \$0.37 | \$0.60 |
| DPS | \$0.30 | \$0.66 | \$0.86 | \$1.00 | \$1.00 | \$1.00 | \$1.00 | \$1.00 | \$1.00 | \$0.49 | \$0.32 | \$0.32 |
| Shares¹ | 142.0 | 133.0 | 130.0 | 130.0 | 133.0 | 129.0 | 131.0 | 132.0 | 133.0 | 132.0 | 137.0 | 137.0 |

Covanta's future growth prospects will mostly come from expanding its customer 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.

¹ Share count is in millions.

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Earnings should return to being positive in 2022. We expect an 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 New York City Marine Transfer Station's operations. 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 this year.

Valuation Analysis

| Year | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | Now | 2026 |
|------------------|------|------|------|------|------|------|------|------|-------|------|-------------|-------------|
| Avg. P/E | 8.9 | 21.4 | --- | --- | 30.4 | --- | 38.6 | 11.6 | 197.3 | --- | 40.3 | 15.0 |
| Avg. Yld. | 2.2% | 3.3% | 3.7% | 3.9% | 6.5% | 6.4% | 5.9% | 7.5% | 6.7% | 3.7% | 2.4% | 3.6% |

There have been a few years where earnings were negative; thus, the PE ratio is very erratic. However, the 10-year PE average is 30.8. We do not think this is a reasonable ratio. We believe a PE of 15 is on par with other companies in the industrial sector.

Safety, Quality, Competitive Advantage, & Recession Resiliency

| Year | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2026 |
|---------------|-------|-------|------|------|--------|------|--------|-------|------|------|------------|------------|
| Payout | 19.5% | 76.7% | --- | --- | 196.1% | --- | 227.3% | 87.0% | --- | --- | 86% | 54% |

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 by \$0.40, then rebounded to \$1.54 in 2011 for an increase of 285%.

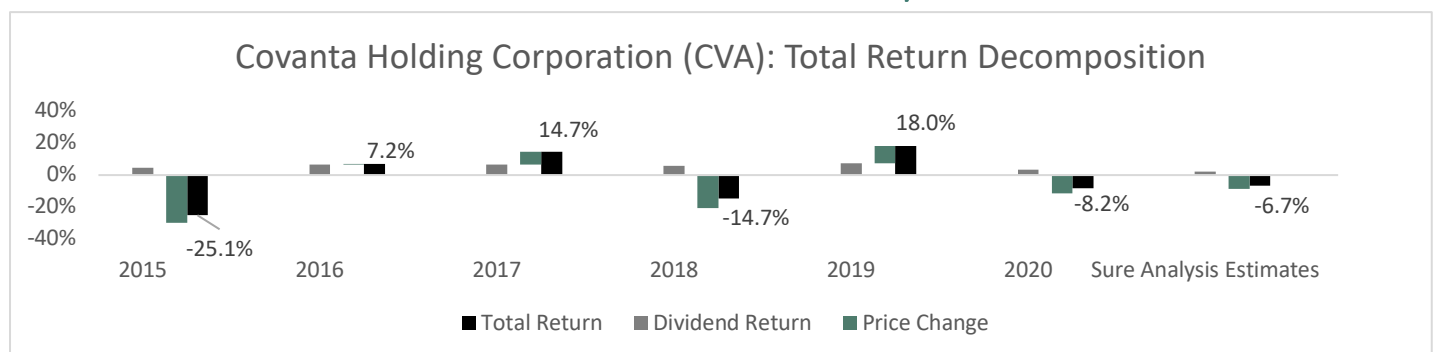
Covanta operates in an industry with high capital expenditures, which creates a barrier to entry; this is its competitive advantage.

Covanta is heavily leveraged, and its balance sheet looks to be stretched thin. The Company only has an interest coverage ratio of 0.8 and a high debt to equity ratio of 8.8. 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 last year by 68%. There is a good chance the Company will cut its dividend again as earnings are expected to be negative this year.

Final Thoughts & Recommendation

Covanta is highly leveraged, and we only see an expected negative return of (6.7)%, which is unsatisfactory for the risk involved with this speculative stock. We rate this company as a Sell at the current price and only for highly speculative investors.

Total Return Breakdown by Year



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Income Statement Metrics

| Year | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|-------------------------|-------|-------|-------|-------|------|-------|------|------|------|-------|
| Revenue | 1650 | 1643 | 1630 | 1682 | 1645 | 1699 | 1752 | 1868 | 1870 | 1904 |
| SG&A Exp. | 84 | 78 | 82 | 97 | 93 | 100 | 112 | 115 | 122 | 120 |
| D&A Exp. | 193 | 194 | 209 | 211 | 198 | 207 | 215 | 218 | 221 | 224 |
| Operating Profit | 254 | 251 | 250 | 218 | 152 | 129 | 103 | 149 | 92 | 88 |
| Operating Margin | 15.4% | 15.3% | 15.3% | 13.0% | 9.2% | 7.6% | 5.9% | 8.0% | 4.9% | 4.6% |
| Net Profit | 219 | 116 | -9 | -2 | 68 | -4 | 57 | 152 | 10 | -28 |
| Net Margin | 13.3% | 7.1% | -0.6% | -0.1% | 4.1% | -0.2% | 3.3% | 8.1% | 0.5% | -1.5% |
| Free Cash Flow | 243 | 215 | 128 | 125 | -122 | -95 | -35 | 32 | 68 | 92 |
| Income Tax | 35 | 31 | 43 | 15 | -84 | 22 | -191 | -29 | -7 | -18 |

Balance Sheet Metrics

| Year | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---------------------------------|------|------|------|------|------|------|------|------|------|------|
| Total Assets | 4385 | 4526 | 4380 | 4206 | 4234 | 4284 | 4441 | 3843 | 3715 | 3706 |
| Cash & Equivalents | 232 | 243 | 195 | 84 | 94 | 84 | 46 | 58 | 37 | 55 |
| Accounts Receivable | 260 | 256 | 264 | 299 | 312 | 332 | 341 | 338 | 240 | 260 |
| Goodwill & Int. Ass. | 809 | 671 | 650 | 605 | 623 | 599 | 600 | 600 | 579 | 539 |
| Total Liabilities | 3297 | 3471 | 3474 | 3422 | 3594 | 3815 | 4014 | 3356 | 3339 | 3396 |
| Accounts Payable | 25 | 40 | 24 | 33 | 90 | 98 | 151 | 76 | 36 | 75 |
| Long-Term Debt | 2166 | 2332 | 2321 | 2198 | 2461 | 2635 | 2523 | 2494 | 2516 | 2539 |
| Shareholder's Equity | 1083 | 1048 | 902 | 782 | 638 | 469 | 427 | 487 | 376 | 310 |
| D/E Ratio | 2.0 | 2.2 | 2.6 | 2.8 | 3.9 | 5.6 | 5.9 | 5.1 | 6.7 | 8.19 |

Profitability & Per Share Metrics

| Year | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|-------------------------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|
| Return on Assets | 4.8% | 2.6% | -0.2% | 0.0% | 1.6% | -0.1% | 1.3% | 3.7% | 0.3% | -0.8% |
| Return on Equity | 19.8% | 10.9% | -0.9% | -0.2% | 9.6% | -0.7% | 12.7% | 33.3% | 2.3% | -8.2% |
| ROIC | 6.5% | 3.5% | -0.3% | -0.1% | 2.2% | -0.1% | 1.9% | 5.1% | 0.3% | -1.0% |
| Shares Out. | 142 | 133 | 130 | 130 | 133 | 129 | 131 | 132 | 133 | 132 |
| Revenue/Share | \$11.62 | \$12.35 | \$12.54 | \$12.94 | \$12.37 | \$13.17 | \$13.37 | \$14.15 | \$14.06 | \$14.42 |
| FCF/Share | \$1.71 | \$1.62 | \$0.98 | \$0.96 | -\$0.92 | -\$0.74 | -\$0.27 | \$0.24 | \$0.51 | \$0.70 |

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

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