

COVANTA HOLDING CORP  
Form 10-Q  
April 19, 2012  
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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 March 31, 2012**

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)*

**445 South Street, Morristown, NJ**  
*(Address of Principal Executive Office)*

**95-6021257**  
*(I.R.S. Employer*

*Identification Number)*

**07960**  
*(Zip Code)*

**(862) 345-5000**

**(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

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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 latest practicable date.

| Class                          | Outstanding at April 12, 2012 |
|--------------------------------|-------------------------------|
| Common Stock, \$0.10 par value | 134,696,443 shares            |

**Table of Contents****COVANTA HOLDING CORPORATION AND SUBSIDIARIES****FORM 10-Q QUARTERLY REPORT****For the Quarter Ended March 31, 2012****PART I. FINANCIAL INFORMATION**

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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 general industry results or broader economic performance in domestic and international markets in which we operate or compete, 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, or 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 its businesses described in Item 1A. Risk Factors of Covanta s Annual Report on Form 10-K for the year ended December 31, 2011 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 OPERATIONS**

|  | <b>For the Three Months Ended<br/>March 31,</b>    |             |
|--|--|-------------|
|  | <b>2012</b>  | <b>2011</b> |
|  | <b>(Unaudited)</b>                                 |             |
|  | <b>(In millions, except per share<br/>amounts)</b> |             |
| <b>OPERATING REVENUES:</b>   |  |             |
| Waste and service revenues   | \$ 258   | \$ 251      |
| Electricity and steam sales  | 91   | 94          |
| Other operating revenues   | 43   | 32          |
| <b>Total operating revenues</b>  | <b>392</b>   | <b>377</b>  |
| <b>OPERATING EXPENSES:</b>   |  |             |
| Plant operating expenses   | 267  | 271         |
| Other operating expenses   | 39   | 28          |
| General and administrative expenses  | 25   | 25          |
| Depreciation and amortization expense  | 50   | 47          |
| Net interest expense on project debt   | 8  | 8           |
| <b>Total operating expenses</b>  | <b>389</b>   | <b>379</b>  |
| <b>Operating income (loss)</b>   | <b>3</b>   | <b>(2)</b>  |
| <b>Other income (expense):</b>   |  |             |
| Interest expense   | (18)   | (17)        |
| Non-cash convertible debt related expense  | (6)  | (5)         |
| Loss on extinguishment of debt   | (2)  |             |
| Other income, net  | 3  |             |
| <b>Total other expenses</b>  | <b>(23)</b>  | <b>(22)</b> |
| Loss from continuing operations before income tax benefit and equity in net income from unconsolidated investments | (20)   | (24)        |
| Income tax benefit   | 8  | 10          |
| Equity in net income from unconsolidated investments   | 1  |             |
| <b>Loss from continuing operations</b>   | <b>(11)</b>  | <b>(14)</b> |
| Income from discontinued operations, net of income tax expense of \$0 and \$2, respectively                        |  | 149         |
| <b>NET (LOSS) INCOME</b>   | <b>(11)</b>  | <b>135</b>  |
| Less: Net income from continuing operations attributable to noncontrolling interests in subsidiaries               | (1)  |             |

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|  |    |        |           |
|--|----|--------|-----------|
| Less: Net income from discontinued operations attributable to noncontrolling interests in subsidiaries |    |        | (2)       |
| Total net income attributable to noncontrolling interests in subsidiaries                              |    | (1)    | (2)       |
| <b>NET (LOSS) INCOME ATTRIBUTABLE TO COVANTA HOLDING CORPORATION</b>                                   | \$ | (12)   | \$ 133    |
| <b>Amounts Attributable to Covanta Holding Corporation stockholders :</b>                              |    |        |           |
| Continuing operations  | \$ | (12)   | \$ (14)   |
| Discontinued operations  |    |        | 147       |
| Net (Loss) Income Attributable to Covanta Holding Corporation  | \$ | (12)   | \$ 133    |
| <b>(Loss) Earnings Per Share Attributable to Covanta Holding Corporation stockholders :</b>            |    |        |           |
| Basic  |    |        |           |
| Continuing operations  | \$ | (0.09) | \$ (0.09) |
| Discontinued operations  |    |        | 1.00      |
| Covanta Holding Corporation  | \$ | (0.09) | \$ 0.91   |
| Weighted Average Shares  |    | 134    | 147       |
| Diluted  |    |        |           |
| Continuing operations  | \$ | (0.09) | \$ (0.09) |
| Discontinued operations  |    |        | 1.00      |
| Covanta Holding Corporation  | \$ | (0.09) | \$ 0.91   |
| Weighted Average Shares  |    | 134    | 147       |
| <b>Cash Dividend Declared Per Share:</b>   | \$ | 0.15   | \$ 0.075  |

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 COMPREHENSIVE INCOME**

|   | <b>Three Months Ended<br/>March 31,<br/>2012            2011<br/>(Unaudited)</b> |        |
|---|--|--------|
|   | <b>( In millions)</b>  |        |
| Net (loss) income   | \$ (11)  | \$ 135 |
| Foreign currency translation  | 1  | 8      |
| Net unrealized gain on available for sale securities, net of tax          | 1  |        |
| Other comprehensive income attributable to Covanta Holding Corporation    | 2  | 8      |
| Comprehensive (loss) income   | (9)  | 143    |
| Less: Net income attributable to noncontrolling interests in subsidiaries | (1)  | (2)    |
| Comprehensive (loss) income attributable to Covanta Holding Corporation   | \$ (10)  | \$ 141 |

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

**Table of Contents****COVANTA HOLDING CORPORATION AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS**

|   | March 31,<br>2012<br>(Unaudited)           | As of<br>December 31,<br>2011 |
|---|--|-------------------------------|
|   | (In millions, except per<br>share amounts) |                               |
| <b>ASSETS</b>   |  |                               |
| <b>Current:</b>   |  |                               |
| Cash and cash equivalents   | \$ 267                                     | \$ 232                        |
| Restricted funds held in trust  | 87   | 101                           |
| Receivables (less allowances of \$5 and \$5, respectively)                    | 226  | 260                           |
| Unbilled service receivables  | 15   | 20                            |
| Deferred income taxes   | 40   | 28                            |
| Prepaid expenses and other current assets                                     | 112  | 105                           |
| Assets held for sale  | 18   | 18                            |
| <b>Total Current Assets</b>   | 765  | 764                           |
| Property, plant and equipment, net  | 2,411                                      | 2,423                         |
| Investments in fixed maturities at market (cost: \$30 and \$31, respectively) | 31   | 31                            |
| Restricted funds held in trust  | 90   | 90                            |
| Unbilled service receivables  | 23   | 25                            |
| Waste, service and energy contracts, net                                      | 425  | 434                           |
| Other intangible assets, net  | 77   | 78                            |
| Goodwill  | 232  | 232                           |
| Investments in investees and joint ventures                                   | 44   | 43                            |
| Other assets  | 316  | 265                           |
| <b>Total Assets</b>   | \$ 4,414                                   | \$ 4,385                      |
| <b>LIABILITIES AND EQUITY</b>   |  |                               |
| <b>Current:</b>   |  |                               |
| Current portion of long-term debt   | \$ 3                                       | \$ 32                         |
| Current portion of project debt   | 136  | 147                           |
| Accounts payable  | 39   | 25                            |
| Deferred revenue  | 74   | 61                            |
| Accrued expenses and other current liabilities                                | 218  | 211                           |
| Liabilities held for sale   | 3  | 3                             |
| <b>Total Current Liabilities</b>  | 473  | 479                           |
| Long-term debt  | 1,570                                      | 1,454                         |
| Project debt  | 507  | 533                           |
| Deferred income taxes   | 638  | 633                           |
| Waste and service contracts   | 73   | 76                            |
| Other liabilities   | 123  | 122                           |
| <b>Total Liabilities</b>  | 3,384                                      | 3,297                         |

**Commitments and Contingencies (Note 13)****Equity:**



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**Covanta Holding Corporation stockholders equity:**

|   |                 |                 |
|---|-----------------|-----------------|
| Preferred stock (\$0.10 par value; authorized 10 shares; none issued and outstanding)                             |                 |                 |
| Common stock (\$0.10 par value; authorized 250 shares; issued 159 and 158 shares; outstanding 135 and 136 shares) | 16              | 16              |
| Additional paid-in capital  | 815             | 824             |
| Accumulated other comprehensive income  | 3               | 1               |
| Accumulated earnings  | 192             | 244             |
| Treasury stock, at par  | (2)             | (2)             |
| <b>Total Covanta Holding Corporation stockholders equity</b>  | <b>1,024</b>    | <b>1,083</b>    |
| Noncontrolling interests in subsidiaries  | 6               | 5               |
| <b>Total Equity</b>   | <b>1,030</b>    | <b>1,088</b>    |
| <b>Total Liabilities and Equity</b>   | <b>\$ 4,414</b> | <b>\$ 4,385</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**

|   | For the Three Months Ended March<br>31, |        |
|---|---|--------|
|   | 2012                                    | 2011   |
|   | (Unaudited)<br>(In millions)            |        |
| <b>OPERATING ACTIVITIES:</b>  |   |        |
| Net (loss) income   | \$ (11)                                 | \$ 135 |
| Less: Income from discontinued operations, net of tax expense   |   | 149    |
| Loss from continuing operations   | (11)                                    | (14)   |
| Adjustments to reconcile net loss from continuing operations to net cash provided by operating activities from continuing operations: |   |        |
| Depreciation and amortization expense   | 50                                      | 47     |
| Amortization of long-term debt deferred financing costs   | 1                                       | 1      |
| Amortization of debt premium and discount   | (1)                                     | (1)    |
| Loss on extinguishment of debt  | 2                                       |        |
| Non-cash convertible debt related expense   | 6                                       | 5      |
| Stock-based compensation expense  | 5                                       | 5      |
| Equity in net income from unconsolidated investments  | (1)                                     |        |
| Dividends from unconsolidated investments   |   | 4      |
| Deferred income taxes   | (7)                                     | (9)    |
| Other, net  | (5)                                     | (1)    |
| Change in restricted funds held in trust  | 2                                       | (15)   |
| Change in working capital, net of effects of acquisitions   | 63                                      | 71     |
| Total adjustments for continuing operations   | 115                                     | 107    |
| Net cash provided by operating activities from continuing operations  | 104                                     | 93     |
| Net cash used in operating activities from discontinued operations  |   | (10)   |
| Net cash provided by operating activities   | 104                                     | 83     |
| <b>INVESTING ACTIVITIES:</b>  |   |        |
| Proceeds from the sale of investment securities   | 1                                       | 5      |
| Purchase of investment securities   |   | (4)    |
| Purchase of property, plant and equipment   | (32)                                    | (38)   |
| Acquisition of land use rights  | (1)                                     |        |
| Other, net  |   | 3      |
| Net cash used in investing activities from continuing operations  | (32)                                    | (34)   |
| Net cash provided by investing activities from discontinued operations  |   | 220    |
| Net cash (used in) provided by investing activities   | (32)                                    | 186    |
| <b>FINANCING ACTIVITIES:</b>  |   |        |
| Proceeds from borrowings on long-term debt  | 699                                     |        |
| Payment of deferred financing costs   | (23)                                    |        |
| Principal payments on long-term debt  | (619)                                   | (2)    |

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|   |        |        |
|---|--------|--------|
| Principal payments on project debt  | (37)   | (74)   |
| Convertible debenture repurchases   | (25)   | (6)    |
| Proceeds from borrowings on project debt                                    |        | 2      |
| Change in restricted funds held in trust                                    | 12     | 44     |
| Cash dividends paid to stockholders   | (10)   |        |
| Common stock repurchased  | (30)   | (54)   |
| Financing of insurance premiums, net  | (3)    |        |
| Distributions to partners of noncontrolling interests in subsidiaries       |        | (2)    |
| Other, net  | (1)    | (2)    |
| Net cash used in financing activities from continuing operations            | (37)   | (94)   |
| Net cash provided by financing activities from discontinued operations      |        | 10     |
| Net cash used in financing activities                                       | (37)   | (84)   |
| Effect of exchange rate changes on cash and cash equivalents                |        | 2      |
| Net increase in cash and cash equivalents                                   | 35     | 187    |
| Cash and cash equivalents at beginning of period                            | 234    | 141    |
| Cash and cash equivalents at end of period                                  | 269    | 328    |
| Less: Cash and cash equivalents of discontinued operations at end of period | 2      | 1      |
| Cash and cash equivalents of continuing operations at end of period         | \$ 267 | \$ 327 |

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 Covanta Energy refer to subsidiary Covanta Energy Corporation and its subsidiaries.

**Organization**

Covanta is one of the world's largest owners and operators of infrastructure for the conversion of waste to energy (known as energy-from-waste or EfW), as well as other waste disposal and renewable energy production businesses. Energy-from-waste serves two key markets as both a sustainable waste disposal solution that is environmentally superior to landfilling and as a source of clean energy that reduces overall greenhouse gas emissions and is considered renewable under the laws of many states and under federal law. Our facilities are critical infrastructure assets that allow our customers, which are principally municipal entities, to provide an essential public service.

Our EfW facilities earn revenue from both the disposal of waste and the generation of electricity, generally under long-term contracts, as well as from the sale of metal recovered during the energy-from-waste process. We process approximately 20 million tons of solid waste annually. We operate and/or have ownership positions in 46 energy-from-waste facilities, which are primarily located in North America, and 15 additional energy generation facilities, including other renewable energy production facilities in North America (wood biomass and hydroelectric). In total, these assets produce approximately 10 million megawatt ( MW ) hours of baseload electricity annually. We also operate a waste management infrastructure that is complementary to our core EfW business.

We own and hold equity interests in energy-from-waste facilities in China and Italy. We are pursuing additional growth opportunities in parts of Europe, primarily in the United Kingdom, where the market demand, regulatory environment or other factors encourage technologies such as energy-from-waste to reduce dependence on landfilling for waste disposal and fossil fuels for energy production in order to reduce greenhouse gas emissions.

We also have investments in subsidiaries engaged in insurance operations in California, primarily in property and casualty insurance; however these collectively account for less than 1% of our consolidated revenue.

We have one reportable segment which is Americas and is comprised of waste and energy services operations primarily in the United States and Canada. For additional information, see Note 5. Financial Information by Business Segments.

**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. All intra-entity accounts and transactions have been eliminated. Operating results for the interim period are not necessarily indicative of the results that may be expected for the fiscal year ended December 31, 2012. This Form 10-Q should be read in conjunction with the Audited Consolidated Financial Statements and accompanying Notes in our Annual Report on Form 10-K for the year ended December 31, 2011 ( Form 10-K ).

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.

**NOTE 2. RECENT ACCOUNTING PRONOUNCEMENTS**

In December 2011, the Financial Accounting Standards Board ( FASB ) and International Accounting Standards Board ( IASB ) issued joint requirements related to balance sheet disclosures related to offsetting assets and liabilities. Entities are required to disclose both gross

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information and net information about both instruments and transactions eligible for offset in the statement of financial position and instruments and transactions subject to an agreement similar to a master netting arrangement. This scope would include derivatives, sale and repurchase agreements and reverse sale and repurchase agreements, and securities borrowing and securities lending arrangements. The objective of this disclosure is to facilitate comparison between those entities that prepare their financial statements on the basis of U.S. GAAP and those entities that prepare their financial statements on the basis of International Financial Reporting Standards ( IFRS ). Disclosures are required to be retrospective for all comparative periods presented. We are required to adopt this standard for the first quarter of 2013. We do not expect this accounting standard to have an impact on our condensed consolidated financial statements.

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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

**NOTE 3. BUSINESS DEVELOPMENT, ASSETS HELD FOR SALE AND DISPOSITIONS**

**Business Development and Organic Growth**

**Alexandria/Arlington County Energy-from-Waste Facility**

We entered into a new tip fee contract with the City of Alexandria and Arlington County to provide for continued waste supply to our Alexandria EfW facility through 2025. Both parties have the option to terminate the agreement in 2019. The agreement also provides the City of Alexandria and Arlington County with the option to extend the agreement to 2038.

**Braintree Transfer Station**

In March 2012, we began a major renovation project to increase recycling capacity at the Braintree transfer station located near our Southeast Massachusetts EfW facility. The project is expected to cost approximately \$7 million and is expected to be completed by the end of 2012. The town of Braintree extended the site lease agreement with the facility to 2030.

**Montgomery County Energy-from-Waste Facility**

We extended the service agreement for our Montgomery County EfW facility and Derwood transfer station from 2016 to 2021 on substantially the same terms as in the existing agreement.

**Niagara Energy-from-Waste Facility**

During the first quarter of 2012, we extended a steam sale contract from 2013 to 2021 for our Niagara EfW facility. This contract combined with new and extended contracts entered in 2011 will increase the steam demand from our customer base and will require us to invest a total of approximately \$10 million in capital expenditures in 2012 and 2013 to install a new natural gas package boiler and steam line to connect to our new customers.

**Organic Growth Investments**

During the three months ended March 31, 2012, we invested approximately \$4 million in various organic growth initiatives by enhancing the capabilities of our existing assets, deploying new or improved technologies targeted at increasing revenue and expanding our customer base and service offerings.

**Assets Held for Sale and Dispositions**

In 2010, we adopted a plan to sell our interests in certain fossil fuel independent power production facilities in the Philippines, India, and Bangladesh. During 2011, we sold the majority of those assets and have one remaining asset held for sale for our interest in a barge-mounted 126 MW (gross) diesel/natural gas-fired electric power generation facility located near Haripur, Bangladesh. In April 2012, we completed the sale of our interest in the Haripur project. For additional information, see Note 14. Subsequent Events.

The assets and liabilities associated with these businesses are presented in our condensed consolidated balance sheets as Current Assets Held for Sale and Current Liabilities Held for Sale. The results of operations of these businesses are included in the condensed consolidated statements of operations as Income from discontinued operations, net of tax. The cash flows of these businesses are also presented separately in our condensed consolidated statements of cash flows.

The following table summarizes the operating results of the discontinued operations for the periods indicated (in millions):

|  | <b>Three Months Ended</b> |             |
|--|---------------------------|-------------|
|  | <b>March 31,</b>          |             |
|  | <b>2012</b>               | <b>2011</b> |
| Revenues   | \$                        | \$ 46       |
| Operating expenses, including net gain on disposal of assets held for sale in 2011 <sup>(1)</sup>          | \$ (1)                    | \$ 99       |
| (Loss) income before income tax benefit (expense) and equity in net income from unconsolidated investments | \$ (1)                    | \$ 146      |
| Equity in net income from unconsolidated investments   | \$ 1                      | \$ 6        |
| Income from discontinued operations, net of income tax expense of \$0 and \$2, respectively                | \$                        | \$ 149      |

(1) During the first quarter of 2011, we recorded a net after-tax gain on disposal of assets held for sale of \$136 million.

**Table of Contents****COVANTA HOLDING CORPORATION AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

The following table sets forth the assets and liabilities of the assets held for sale included in the condensed consolidated balance sheets as of the dates indicated (in millions):

|   | As of             |                      |
|---|-------------------|----------------------|
|   | March 31,<br>2012 | December 31,<br>2011 |
| Cash and cash equivalents                   | \$ 2              | \$ 2                 |
| Accounts receivable                         | 1                 | 1                    |
| Investments in investees and joint ventures | 15                | 15                   |
| Assets held for sale                        | \$ 18             | \$ 18                |
| Accrued expenses and other                  | \$ 3              | \$ 3                 |
| Liabilities held for sale                   | \$ 3              | \$ 3                 |

**NOTE 4. EARNINGS PER SHARE ( EPS )**

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 awards, restricted stock units 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 millions, except per share amounts).

|   | Three Months<br>Ended March 31, |           |
|---|---------------------------------|-----------|
|   | 2012                            | 2011      |
| Net loss from continuing operations                           | \$ (12)                         | \$ (14)   |
| Net income from discontinued operations                       |                                 | 147       |
| Net (loss) income attributable to Covanta Holding Corporation | \$ (12)                         | \$ 133    |
| <b>Basic (loss) earnings per share:</b>                       |                                 |           |
| Weighted average basic common shares outstanding              | 134                             | 147       |
| Continuing operations   | \$ (0.09)                       | \$ (0.09) |
| Discontinued operations                                       |                                 | 1.00      |
| Covanta Holding Corporation                                   | \$ (0.09)                       | \$ 0.91   |
| <b>Diluted (loss) earnings per share:</b>                     |                                 |           |
| Weighted average basic common shares outstanding              | 134                             | 147       |



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|   |           |           |
|---|-----------|-----------|
| Dilutive effect of stock options  |           |           |
| Dilutive effect of restricted stock   |           |           |
| Dilutive effect of warrants   |           |           |
| Weighted average diluted common shares outstanding  | 134       | 147       |
| Continuing operations   | \$ (0.09) | \$ (0.09) |
| Discontinued operations   |           | 1.00      |
| Covanta Holding Corporation   | \$ (0.09) | \$ 0.91   |
| Securities excluded from the weighted average dilutive common shares outstanding because their inclusion would have been anti-dilutive: |           |           |
| Stock options   |           | 2         |
| Restricted stock  | 1         | 1         |
| Restricted stock units  |           | 1         |
| Warrants  | 28        | 27        |

**Table of Contents****COVANTA HOLDING CORPORATION AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

In 2009, we entered into privately negotiated warrant transactions in connection with the issuance of 3.25% Cash Convertible Senior Notes due 2014 (the 3.25% Notes). These warrants could have a dilutive effect to the extent that the price of our common stock exceeds the applicable strike price of \$22.78. As of March 31, 2012, the warrants did not have a dilutive effect on earnings per share because the average market price during the periods presented was below the strike price.

**NOTE 5. FINANCIAL INFORMATION BY BUSINESS SEGMENTS**

We have one reportable segment which is Americas and is comprised of waste and energy services operations primarily in the United States and Canada. The results of our reportable segment are as follows (in millions):

|   | Americas | All Other<br>(1) | Total  |
|---|----------|------------------|--------|
| <b>Three Months Ended March 31, 2012:</b> |          |                  |        |
| Operating revenues                        | \$ 381   | \$ 11            | \$ 392 |
| Depreciation and amortization expense     | 49       | 1                | 50     |
| Operating income (loss)                   | 9        | (6)              | 3      |
| <b>Three Months Ended March 31, 2011:</b> |          |                  |        |
| Operating revenues                        | \$ 367   | \$ 10            | \$ 377 |
| Depreciation and amortization expense     | 47       |                  | 47     |
| Operating income (loss)                   | 7        | (9)              | (2)    |

(1) All other is comprised of the financial results of our insurance subsidiaries' operations and our remaining international assets that are not classified as assets held for sale. See Note 3. Business Development, Assets Held for Sale and Dispositions.

**NOTE 6. CHANGES IN CAPITALIZATION****2012 Debt Refinancing**

During the first quarter of 2012, we completed a refinancing of our previously existing senior secured credit facilities issued by our subsidiary, Covanta Energy, which consisted of a \$300 million revolving credit facility, a \$320 million funded letter of credit facility and a \$619 million term loan (\$650 million original amount), by entering into \$1.2 billion in new senior secured credit facilities (the 2012 Credit Facilities; see below for details) issued by our subsidiary, Covanta Energy, comprised of a \$900 million revolving credit facility that expires in 2017 (the Revolving Credit Facility) and a \$300 million term loan due 2019 (the Term Loan), and by issuing \$400 million aggregate principal amount of 6.375% senior notes due 2022 (the 6.375% Notes; see below for details). The proceeds from the Term Loan and a portion of the proceeds from the 6.375% Notes were used to repay the previously existing term loan, as well as to pay transaction expenses, while the Revolving Credit Facility replaced the previously existing \$300 million revolving credit facility and \$320 million funded letter of credit facility. The Revolving Credit Facility, which was undrawn at March 31, 2012, is available both for the issuance of letters of credit (\$275 million outstanding as of March 31, 2012) and for borrowings for general corporate purposes.

As a result of the refinancing, we recognized a loss on extinguishment of debt of approximately \$2 million, pre-tax, during the three months ended March 31, 2012, which was comprised of the write-off of deferred financing costs in connection with previously existing financing arrangements.

**Table of Contents****COVANTA HOLDING CORPORATION AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)****Long-Term Debt**

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

|  | March 31,<br>2012 | As of<br>December 31,<br>2011 |
|--|-------------------|-------------------------------|
| 7.25% Senior Notes due 2020                                  | \$ 400            | \$ 400                        |
| 6.375% Senior Notes due 2022                                 | 400               |                               |
| 1.00% Senior Convertible Debentures due 2027 <sup>(1)</sup>  |                   | 25                            |
| 3.25% Cash Convertible Senior Notes due 2014                 | 460               | 460                           |
| Debt discount related to 3.25% Cash Convertible Senior Notes | (61)              | (67)                          |
| Cash conversion option derivative at fair value              | 75                | 49                            |
| <b>3.25% Cash Convertible Senior Notes, net</b>              | <b>474</b>        | <b>442</b>                    |
| Term loan  | 300               | 619                           |
| Debt discount related to Term loan                           | (1)               |                               |
| Term loan, net   | 299               | 619                           |
| <b>Total</b>   | <b>1,573</b>      | <b>1,486</b>                  |
| Less: current portion  | (3)               | (32)                          |
| <b>Total long-term debt</b>                                  | <b>\$ 1,570</b>   | <b>\$ 1,454</b>               |

(1) The remaining outstanding Debentures were redeemed at par during the first quarter of 2012. See additional information below under *1.00% Senior Convertible Debentures due 2027*.

**2012 Credit Facilities**

The following is a comparison of our previously existing credit facilities and the 2012 Credit Facilities issued by our subsidiary, Covanta Energy (in millions):

|   | Credit Facilities |                   |
|---|-------------------|-------------------|
|   | As of             |                   |
|   | March 31, 2012    | December 31, 2011 |
| Term loan                                 | \$ 300            | \$ 650            |
| Revolving credit facility                 | \$ 900            | \$ 300            |
| Funded letter of credit facility          | N/A               | \$ 320            |
| Total capacity to issue letters of credit | \$ 900            | \$ 520            |

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The Revolving Credit Facility is available for the issuance of letters of credit up to the full amount of the facility, provides for a \$50 million sub-limit for the issuance of swing line loans (a loan that can be requested in US Dollars on a same day basis for a short drawing period); and is available in US Dollars, Euros, Pounds Sterling, Canadian Dollars and certain other currencies to be agreed upon, in each case for either borrowings for the issuance of letters of credit.

We have the option to issue additional term loans and/or increase the size of the Revolving Credit Facility (collectively, the Incremental Facilities ), subject to the satisfaction of certain conditions and obtaining sufficient lender commitments, in an amount up to the greater of \$500 million and the amount that, after giving effect to the incurrence of such Incremental Facilities, would not result in a leverage ratio, as defined in the credit agreement governing the 2012 Credit Facilities (the Credit Agreement ), exceeding 2.75:1.00.

The proceeds of the Term Loan were used, together with a portion of the proceeds of the 6.375% Notes offering (see *6.375% Senior Notes due 2022* below for details), to refinance the previously existing credit facilities and to pay the related fees and expenses. The proceeds under the Revolving Credit Facility are available for working capital and general corporate purposes of Covanta Energy and its subsidiaries.

**Table of Contents****COVANTA HOLDING CORPORATION AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)****Availability under Revolving Credit Facility**

As of March 31, 2012, we had availability under the Revolving Credit Facility as follows (in millions):

|                           | Total Available Under Credit Facility | Maturing | Outstanding Borrowings as of March 31, 2012 | Outstanding Letters of Credit as of March 31, 2012 | Available as of March 31, 2012 |
|---------------------------|---------------------------------------|----------|---|--|--------------------------------|
| Revolving Credit Facility | \$ 900                                | 2017     | \$  | \$ 275   | \$ 625                         |

**Repayment Terms**

The Term Loan has mandatory quarterly amortization payments beginning June 30, 2012 through the date of maturity as follows (in millions):

|                               | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019   | Total  |
|-------------------------------|------|------|------|------|------|------|------|--------|--------|
| Annual Remaining Amortization | \$ 2 | \$ 3 | \$ 3 | \$ 3 | \$ 3 | \$ 3 | \$ 3 | \$ 280 | \$ 300 |

The 2012 Credit Facilities (both the Term Loan and Revolving Credit Facility) are pre-payable at our option at any time. In the event that all or any portion of the Term Loan is voluntarily prepaid in relation to a repricing or refinancing transaction resulting in lower pricing for us on or prior to March 28, 2013, however, we shall pay a fee to the lenders equal to 1.00% of the amount so prepaid.

Under certain circumstances, the 2012 Credit Facilities obligate us to apply 25% of our excess cash flow (as defined in the Credit Agreement) for each fiscal year commencing in 2013, as well as net cash proceeds from specified other sources, such as asset sales or insurance proceeds, to prepay the Term Loan, provided that this excess cash flow percentage shall be reduced to 0% in the event the leverage ratio is at or below 3.00:1.00.

**Interest and Fees**

Borrowings under the 2012 Credit Facilities bear interest, at our option, at either a base rate or a Eurodollar rate plus an applicable margin determined by pricing grids, which are based on Covanta Energy's leverage ratio. Base rate is defined as the higher of (i) the Federal Funds Effective Rate plus 0.50%, (ii) the rate the administrative agent announces from time to time as its per annum prime rate or (iii) the one-month LIBOR rate plus 1.00%. Eurodollar rate borrowings bear interest at the British Bankers' Association LIBOR Rate, commonly referred to as LIBOR, for the interest period selected by us. Base rate borrowings under the Revolving Credit Facility shall bear interest at the base rate plus an applicable margin ranging from 1.25% to 1.75%. Eurodollar borrowings under the Revolving Credit Facility shall bear interest at LIBOR plus an applicable margin ranging from 2.00% to 2.75%. Fees for issuances of letters of credit include fronting fees equal to 0.125% per annum and a participation fee for the lenders equal to the applicable interest margin for LIBOR rate borrowings. We will incur an unused commitment fee ranging from 0.375% to 0.50% on the unused amount of commitments under the Revolving Credit Facility. The Term Loan bears interest, at our option, at either (i) the base rate plus an applicable margin ranging from 1.75% to 2.00%, or (ii) LIBOR plus an applicable margin ranging from 2.75% to 3.00%, subject to a LIBOR floor of 1.00%.

**Guarantees and Securitization**

The 2012 Credit Facilities are guaranteed by us and by certain of our subsidiaries. The subsidiaries that are party to the 2012 Credit Facilities agreed to secure all of the obligations under the 2012 Credit Facilities by granting, for the benefit of secured parties, a first priority lien on substantially all of their assets, to the extent permitted by existing contractual obligations; a pledge of substantially all of the capital stock of each of our domestic subsidiaries and 65% of substantially all the capital stock of each of our foreign subsidiaries which are directly owned, in each case to the extent not otherwise pledged.

*Credit Agreement Covenants*

The loan documentation under the 2012 Credit Facilities contains various affirmative and negative covenants, as well as financial maintenance covenants, that limit our ability to engage in certain types of transactions. We were in compliance with all required covenants as of March 31, 2012.

The negative covenants of the 2012 Credit Facilities limit our and our restricted subsidiaries' ability to, among other things:

- incur additional indebtedness (including guarantee obligations);
- create certain liens against or security interests over certain property;
- pay dividends on, redeem, or repurchase our capital stock or make other restricted junior payments;

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**COVANTA HOLDING CORPORATION AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

enter into agreements that restrict the ability of our subsidiaries to make distributions or other payments to us;  
make investments;  
consolidate, merge or transfer all or substantially all of our assets and the assets of our subsidiaries on a consolidated basis;  
dispose of certain assets; and  
make certain acquisitions.

The financial maintenance covenants of the 2012 Credit Facilities, which are measured on a trailing four quarter period basis, include the following:

a maximum Leverage Ratio of 4.00 to 1.00 for the trailing four quarter period, which measures the principal amount of Covanta Energy's consolidated debt less certain restricted funds dedicated to repayment of project debt principal and construction costs ( Consolidated Adjusted Debt ) to its adjusted earnings before interest, taxes, depreciation and amortization, as calculated in the Credit Agreement ( Adjusted EBITDA ). The definition of Adjusted EBITDA in the 2012 Credit Facilities excludes certain non-recurring and non-cash charges.

a minimum Interest Coverage Ratio of 3.00 to 1.00, which measures Covanta Energy's Adjusted EBITDA to its consolidated interest expense plus certain interest expense of ours, to the extent paid by Covanta Energy as calculated in the Credit Agreement.

**6.375% Senior Notes due 2022**

In March 2012, we sold \$400 million aggregate principal amount of 6.375% Senior Notes due 2022. Interest on the 6.375% Notes is payable semi-annually on April 1 and October 1 of each year, commencing on October 1, 2012, and the 6.375% Notes will mature on October 1, 2022 unless earlier redeemed or repurchased. Net proceeds from the sale of the 6.375% Notes were \$392 million, consisting of gross proceeds of \$400 million net of \$8 million in offering expenses. We used a portion of the net proceeds of the 6.375% Notes offering to repay a portion of the amounts outstanding under Covanta Energy's previously existing term loan.

The 6.375% Notes are senior unsecured obligations, ranking equally in right of payment with any of the future senior unsecured indebtedness of Covanta Holding Corporation. The 6.375% Notes are effectively junior to our existing and future secured indebtedness, including any guarantee of indebtedness under the credit facilities of our subsidiary, Covanta Energy. The 6.375% Notes are not guaranteed by any of our subsidiaries and are effectively subordinated to all existing and future indebtedness and other liabilities of our subsidiaries.

The indenture for the 6.375% Notes may limit our ability and the ability of certain of our subsidiaries to:

incur additional indebtedness;  
pay dividends or make other distributions or repurchase or redeem their capital stock;  
prepay, redeem or repurchase certain debt;  
make loans and investments;  
sell restricted assets;  
incur liens;  
enter into transactions with affiliates;  
alter the businesses they conduct;  
enter into agreements restricting our subsidiaries' ability to pay dividends; and  
consolidate, merge or sell all or substantially all of their assets.

If and for so long as the 6.375% Notes have an investment grade rating and no default under the indenture has occurred, certain of the covenants will be suspended. At our option, the 6.375% Notes are subject to redemption at any time on or after April 1, 2017, in whole or in part, at the redemption prices set forth in the indenture, together with accrued and unpaid interest, if any, to the date of redemption. At any time prior to

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April 1, 2015, we may redeem up to 35% of the original principal amount of the 6.375% Notes with the proceeds of certain equity offerings at a redemption price of 106.375% of their principal amount, together with accrued and unpaid interest, if any, to the date of redemption. In addition, at any time prior to April 1, 2017, we may redeem some or all of the 6.375% Notes at a price equal to 100% of their principal amount, plus accrued and unpaid interest, plus a make-whole premium .

If we sell certain of our assets or experience specific kinds of changes in control, we must offer to purchase the 6.375% Notes. The occurrence of specific kinds of changes in control will be a triggering event requiring us to offer to purchase from the holders all or a portion of the 6.375% Notes at a price equal to 101% of their principal amount, together with accrued and unpaid interest, if any, to the date of purchase. In addition, certain asset dispositions will be triggering events that may require us to use the proceeds from those asset dispositions to make an offer to purchase the 6.375% Notes at 100% of their principal amount, together with accrued and unpaid interest, if any, to the date of purchase if such proceeds are not otherwise used within 365 days to repay indebtedness or to invest or commit to invest such proceeds in additional assets related to our business or capital stock of a restricted subsidiary.



**Table of Contents****COVANTA HOLDING CORPORATION AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)****7.25% Senior Notes due 2020 (the 7.25% Notes )**

For specific criteria related to redemption features of the 7.25% Notes, refer to Note 11 of the Notes to Consolidated Financial Statements in our Form 10-K.

**3.25% Cash Convertible Senior Notes due 2014 (the 3.25% Notes )**

Under limited circumstances, the 3.25% Notes are convertible by the holders thereof into cash only, based on a conversion rate of 60.3521 shares of our common stock per \$1,000 principal amount of 3.25% Notes (which represents a conversion price of approximately \$16.57 per share) subject to certain customary adjustments as provided in the indenture for the 3.25% Notes. We will not deliver common stock (or any other securities) upon conversion under any circumstances.

The debt discount related to the 3.25% Notes is accreted over their term and recognized as non-cash convertible debt related expense. The following table details the amount of the accretion of debt discount as of March 31, 2012 expected to be included in our condensed consolidated financial statements for each of the periods indicated (in millions):

|  | For the Years Ended |       |       |
|--|---------------------|-------|-------|
|  | 2012                | 2013  | 2014  |
| 3.25% Cash Convertible Senior Notes due 2014 | \$ 19               | \$ 29 | \$ 13 |

For specific criteria related to contingent interest, conversion or redemption features of the 3.25% Notes and details related to the cash conversion option, cash convertible note hedge and warrants related to the 3.25% Notes, refer to Note 11 of the Notes to Consolidated Financial Statements in our Form 10-K.

For details related to the fair value for the contingent interest feature, cash conversion option, and cash convertible note hedge related to the 3.25% Notes, see Note 12. Derivative Instruments.

**1.00% Senior Convertible Debentures due 2027 (the Debentures )**

As of December 31, 2011, there were \$25 million aggregate principal amount of the Debentures outstanding. On February 1, 2012, holders of \$23 million of outstanding Debentures exercised their option for us to redeem the Debentures at par. The Debentures were also subject to redemption at our option at any time on or after February 1, 2012, and we subsequently redeemed the remaining \$2 million of outstanding Debentures on March 23, 2012.

**Equity**

During the three months ended March 31, 2012, we granted 719,566 restricted stock awards and 108,164 restricted stock units. For information related to stock-based award plans, see Note 10. Stock-Based Compensation.

During the three months ended March 31, 2012, we repurchased 280,831 shares of our common stock in connection with tax withholdings for vested stock awards.

Dividends declared to stockholders are as follows (in millions, except per share amounts):

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|                       | Three Months Ended |          |
|-----------------------|--------------------|----------|
|                       | March 31,          |          |
|                       | 2012               | 2011     |
| Regular cash dividend |                    |          |
| Declared              | \$ 21              | \$ 11    |
| Per Share             | \$ 0.15            | \$ 0.075 |

During the three months ended March 31, 2012, the Board of Directors approved an additional \$100 million share repurchase authorization. Under the program, common stock repurchases may be made in the open market, in privately negotiated transactions from time to time, or by other available methods, at management's discretion in accordance with applicable federal securities laws. The timing and amounts of any repurchases will depend on many factors, including our capital structure, the market price of our common stock and overall market conditions. As of March 31, 2012, the amount remaining under our currently authorized share repurchase program was \$145 million. Common stock repurchased is as follows (in millions, except per share amounts):

|                                   | Amount | Shares Repurchased | Weighted Average Cost per Share |
|-----------------------------------|--------|--------------------|---------------------------------|
| Three months ended March 31, 2012 | \$ 30  | 1.8                | \$ 16.45                        |

**Table of Contents****COVANTA HOLDING CORPORATION AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)*****Noncontrolling interests in subsidiaries***

Noncontrolling interests in subsidiaries is as follows (in millions):

|  | <b>For the Three<br/>Months<br/>Ended March 31,</b> |              |
|--|---|--------------|
|  | <b>2012</b>   | <b>2011</b>  |
| Noncontrolling interests in subsidiaries, balance as of beginning of period  | \$ 5  | \$ 33        |
| Elimination due to sale of controlling interests in subsidiaries             |   | (18)         |
| Distributions to partners of noncontrolling interests in subsidiaries        |   | (2)          |
| Net income   | 1   | 2            |
| <b>Noncontrolling interests in subsidiaries, balance as of end of period</b> | <b>\$ 6</b>   | <b>\$ 15</b> |

**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 for the year ending December 31, 2012 to be approximately 40.7%. We review the annual effective tax rate on a quarterly basis as projections are revised and laws are enacted. The effective income tax rate was approximately 38.0 % and 42.2% for the three months ended March 31, 2012 and 2011, respectively. The decrease in the effective tax rate is primarily due to a decrease in the foreign tax rate differential and lower investment income forecasted by the Grantor Trusts. The liability for uncertain tax positions, exclusive of interest and penalties, was \$119 million as of both March 31, 2012 and December 31, 2011. Included in the balance of unrecognized tax benefits as of March 31, 2012 are potential benefits of \$119 million that, if recognized, would impact the effective tax rate.

For the three months ended March 31, 2012 and 2011, we recognized a net tax expense of less than \$1 million and a net tax expense of \$1 million, respectively, for interest and penalties on uncertain tax positions. We had accrued interest and penalties associated with liabilities for unrecognized tax positions of \$2 million for both March 31, 2012 and December 31, 2011. We continue to reflect interest accrued on uncertain tax positions and penalties as part of the tax provision.

In the ordinary course of our business, the Internal Revenue Service ( IRS ) and state tax authorities will periodically audit our federal and state tax returns. As issues are examined by the IRS and state auditors, we may decide to adjust the existing liability for uncertain tax positions for issues that were not previously deemed an exposure. Federal income tax returns for Covanta Energy are closed for the years through 2003. However, to the extent net operating loss carryforwards ( NOLs ) are utilized from earlier years, federal income tax returns for Covanta Holding Corporation, formerly known as Danielson Holding Corporation, are still open. 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, 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.

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While we cannot predict 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 of Insurance nor the final administration by the Director of the Division of Insurance for the State of Missouri will result in a material reduction in available NOLs.

We have consolidated federal NOLs estimated to be approximately \$427 million for federal income tax purposes as of December 31, 2011, based on the income tax returns filed. The federal NOLs will expire in various amounts from December 31, 2023 through December 31, 2030, if not used. In addition to the consolidated federal NOLs, as of December 31, 2011, we had state NOL carryforwards of approximately \$223 million, which expire between 2012 and 2031, capital loss carryforwards of \$4 million expiring between 2012 and 2015, net foreign NOL carryforwards of approximately \$2 million expiring between 2015 and 2031, and federal tax credit carryforwards, including production tax credits of \$44 million expiring between 2014 and 2022, and minimum tax credits of \$7 million with no expiration. These deferred tax assets are offset by a valuation allowance of approximately \$22 million.

For further information, refer to Note 16. Income Taxes of the Notes to the Consolidated Financial Statements in our Form 10-K.

**Table of Contents****COVANTA HOLDING CORPORATION AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)****NOTE 8. SUPPLEMENTARY INFORMATION****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 \$22 million and \$23 million for the three months ended March 31, 2012 and 2011, respectively.

*Other operating expenses*

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

|  | <b>For the Three Months<br/>Ended March 31,</b> |             |
|--|---|-------------|
|  | <b>2012</b>                                     | <b>2011</b> |
| Construction costs                                     | \$ 38   | \$ 26       |
| Insurance subsidiary operating expenses <sup>(1)</sup> | 3   | 4           |
| Other  | (2)   | (2)         |
| Total other operating expenses                         | \$ 39   | \$ 28       |

(1) Insurance subsidiary operating expenses are primarily comprised of incurred but not reported loss reserves, loss adjustment expenses and policy acquisition costs.

*Amortization of waste, service and energy contracts*

Our waste, service and energy contracts are intangible assets and liabilities relating to long-term operating contracts at acquired facilities and are recorded upon acquisition at their estimated fair market values based upon discounted cash flows. Intangible assets and liabilities are amortized using the straight line method over their remaining useful lives.

The following table details the amount of the actual/estimated amortization expense and contra-expense associated with these intangible assets and liabilities as of March 31, 2012 included or expected to be included in our condensed consolidated statement of operations for each of the years indicated (in millions):

|                                   | <b>Waste, Service and<br/>Energy Contracts<br/>(Amortization Expense)</b> | <b>Waste and Service<br/>Contracts<br/>(Contra-Expense)</b> |
|-----------------------------------|---|---|
| Three Months ended March 31, 2012 | \$ 9  | \$ (3)  |

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|                   |    |     |    |      |
|-------------------|----|-----|----|------|
| Remainder of 2012 | \$ | 26  | \$ | (9)  |
| 2013              |    | 32  |    | (12) |
| 2014              |    | 29  |    | (13) |
| 2015              |    | 26  |    | (8)  |
| 2016              |    | 23  |    | (8)  |
| Thereafter        |    | 289 |    | (23) |
| Total             | \$ | 425 | \$ | (73) |

*Stanislaus Efw Facility*

On January 14, 2012, our Stanislaus, California energy-from-waste facility experienced a turbine generator failure. Damage to the turbine generator was extensive and operations at the facility were suspended promptly to assess the cause and extent of damage. The facility is capable of processing waste without utilizing the turbine generator to generate electricity, and we resumed waste processing operations during the first quarter of 2012. We expect the facility will not be able to generate electricity for a substantial portion of 2012. The cost of repair or replacement, and business interruption losses, are insured under the terms of applicable insurance policies, subject to deductibles. We believe this event will not have a material adverse impact on our results of operations, financial position or cash flows.

**Table of Contents****COVANTA HOLDING CORPORATION AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)****Non-Cash Convertible Debt Related Expense**

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

|   | Three Months Ended<br>March 31, |             |
|---|---------------------------------|-------------|
|   | 2012                            | 2011        |
| Debt discount accretion related to the 3.25% Notes                  | \$ 6                            | \$ 6        |
| Debt discount accretion related to the Debentures                   |                                 | 1           |
| Fair value changes related to the cash convertible note hedge       | (27)                            | 9           |
| Fair value changes related to the cash conversion option derivative | 27                              | (11)        |
| <b>Total non-cash convertible debt related expense</b>              | <b>\$ 6</b>                     | <b>\$ 5</b> |

**Other Income, Net**

For the three months ended March 31, 2012, other income, net included a \$3 million foreign currency gain related to intercompany loans.

**NOTE 9. BENEFIT OBLIGATIONS****Pension and Other Benefit Obligations**

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

|                                  | Pension Benefits<br>For the Three<br>Months Ended<br>March 31, |           |
|----------------------------------|--|-----------|
|                                  | 2012   | 2011      |
| Interest cost                    | \$ 1   | \$ 1      |
| Expected return on plan assets   | (1)  | (1)       |
| <b>Net periodic benefit cost</b> | <b>\$</b>  | <b>\$</b> |

Interest costs and the expected return on plan assets for other post-retirement benefits were not material for the three months ended March 31, 2012 and 2011.

Effective December 31, 2005, we froze service accruals in the defined benefit pension plan for employees in the United States who did not participate in retirement plans offered by collective bargaining units or our insurance subsidiaries. All active employees who were eligible participants in the defined benefit pension plan, as of December 31, 2005, became 100% vested and have a non-forfeitable right to these benefits as of such date. During the second quarter of 2011, we informed employees who were eligible participants in the pension plan of our plan to terminate the pension plan, subject to approval by the IRS, with the intention of fully distributing plan assets as promptly as practicable following such approval. The actual settlement amount will fluctuate based on future market performance, such as the interest rate at the final settlement, actual return on plan assets, and employees' disbursement elections. The actual settlement will take place following receipt of IRS approval.

**Defined Contribution Plans**

Substantially all of our employees in the United States are eligible to participate in defined contribution plans we sponsor. Our costs related to defined contribution plans were \$4 million for both the three months ended March 31, 2012 and 2011.

**NOTE 10. STOCK-BASED COMPENSATION**

During the three months ended March 31, 2012, we awarded certain employees 719,566 restricted stock awards. The restricted stock awards will be expensed over the requisite service period, subject to an assumed 12% average forfeiture rate. The terms of the restricted stock awards include vesting provisions based solely on continued service. If the service criteria are satisfied, the restricted stock awards vest during March of 2013, 2014, and 2015.

During the three months ended March 31, 2012, we awarded certain employees 108,164 shares of restricted stock units ( RSUs ) under the Growth Equity Plan. The Growth Equity Plan provides for the award of RSUs to certain employees in connection with specified growth-based acquisitions that have been completed or development projects that have commenced. Vesting of RSUs will not



**Table of Contents****COVANTA HOLDING CORPORATION AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

occur until at least three years have passed following an acquisition, or upon the later of three years from the grant date or one year following the commencement of commercial operations for development projects. Upon the vesting date, the Compensation Committee will re-calculate the net present values of the cash flows ( Bring Down NPV ). If the ratio of the Bring Down NPV to the Projected NPV is greater than 95% all of the RSUs related to the particular project will vest. If the ratio is less than 95%, the number of RSUs originally issued will be proportionately reduced.

Compensation expense related to our stock-based awards totaled \$5 million for both the three months ended March 31, 2012 and 2011. Unrecognized stock-based compensation expense and weighted-average years to be recognized is as follows (in millions, except for weighted average years):

|                         | As of March 31, 2012                      |  |
|-------------------------|---|--|
|                         | Unrecognized stock-<br>based compensation | Weighted-average years<br>to be recognized |
| Restricted Stock Awards | \$ 15                                     | 2  |
| Restricted Stock Units  | \$ 4                                      | 2  |
| Stock Options           | \$  |  |

**NOTE 11. FINANCIAL INSTRUMENTS****Fair Value Measurements**

The following methods and assumptions were used to estimate the fair value of each class of financial instruments:

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 long-term debt and project debt are determined using quoted market prices.

The fair value of the note hedge and the cash conversion option are determined using an option pricing model based on observable inputs such as implied volatility, risk free interest rate, and other factors. The fair value of the note hedge is adjusted to reflect counterparty risk of non-performance, and is based on the counterparty's credit spread in the credit derivatives market. The contingent interest features related to the Debentures and the 3.25% 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 March 31, 2012. Such amounts have not been comprehensively revalued for purposes of these financial statements since March 31, 2012, and current estimates of fair value may differ significantly from the amounts presented herein.

**Table of Contents****COVANTA HOLDING CORPORATION AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

The following table presents information about the fair value measurement of our assets and liabilities as of March 31, 2012:

|   | As of March 31, 2012 |                      | Fair Value Measurements at Reporting Date Using                                 |   |   |
|---|----------------------|----------------------|---|---|---|
|   | Carrying Amount      | Estimated Fair Value | Quoted Prices in Active Markets for Identical Assets (Level 1)<br>(In millions) | Significant Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| <b>Financial Instruments Recorded at Fair Value on a Recurring Basis:</b> |                      |                      |   |   |   |
| <b>Assets:</b>  |                      |                      |   |   |   |
| Cash and cash equivalents:  |                      |                      |   |   |   |
| Bank deposits and certificates of deposit                                 | \$ 260               | \$ 260               | \$ 260  | \$                                      | \$  |
| Money market funds  | 7                    | 7                    | 7   |   |   |
| Total cash and cash equivalents:  | 267                  | 267                  | 267   |   |   |
| Restricted funds held in trust:   |                      |                      |   |   |   |
| Bank deposits and certificates of deposit                                 | 2                    | 2                    | 2   |   |   |
| Money market funds  | 105                  | 105                  | 105   |   |   |
| U.S. Treasury/Agency obligations <sup>(1)</sup>                           | 16                   | 16                   | 16  |   |   |
| State and municipal obligations   | 9                    | 9                    | 9   |   |   |
| Commercial paper/Guaranteed investment contracts/Repurchase agreements    | 45                   | 45                   | 45  |   |   |
| Total restricted funds held in trust:                                     | 177                  | 177                  | 177   |   |   |
| Restricted funds other:   |                      |                      |   |   |   |
| Bank deposits and certificates of deposit <sup>(2)(3)</sup>               | 4                    | 4                    | 4   |   |   |
| Money market funds <sup>(3)</sup>   | 8                    | 8                    | 8   |   |   |
| Residential mortgage-backed securities <sup>(3)</sup>                     | 1                    | 1                    | 1   |   |   |
| Total restricted funds other:   | 13                   | 13                   | 13  |   |   |
| Investments:  |                      |                      |   |   |   |
| Mutual and bond funds <sup>(2)</sup>                                      | 2                    | 2                    | 2   |   |   |
| Investments available for sale:   |                      |                      |   |   |   |
| U.S. Treasury/Agency obligations <sup>(4)</sup>                           | 7                    | 7                    | 7   |   |   |
| Residential mortgage-backed securities <sup>(4)</sup>                     | 7                    | 7                    | 7   |   |   |
| Other government obligations <sup>(4)</sup>                               | 3                    | 3                    | 3   |   |   |
| Corporate investments <sup>(4)</sup>                                      | 14                   | 14                   | 14  |   |   |
| Equity securities <sup>(3)</sup>  | 1                    | 1                    | 1   |   |   |
| Total investments:  | 34                   | 34                   | 34  |   |   |
| Derivative Asset Note Hedge   | 74                   | 74                   |   | 74                                      |   |
| Derivative Asset Energy Hedges  | 5                    | 5                    |   | 5                                       |   |
| Total assets:   | \$ 570               | \$ 570               | \$ 491  | \$ 79                                   | \$  |

**Liabilities:**

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|                        |                                     |    |    |    |    |    |    |    |
|------------------------|-------------------------------------|----|----|----|----|----|----|----|
| Derivative Liability   | Cash Conversion Option              | \$ | 75 | \$ | 75 | \$ | 75 | \$ |
| Derivative Liabilities | Contingent interest features of the |    | 0  |    | 0  |    | 0  |    |
|                        | 3.25% Notes                         |    |    |    |    |    |    |    |
| Total liabilities:     |                                     | \$ | 75 | \$ | 75 | \$ | 75 | \$ |

| Financial Instruments Recorded at Carrying Amount: | As of March 31, 2012 |                      |
|--|----------------------|----------------------|
|  | Carrying Amount      | Estimated Fair Value |
| <b>Assets:</b>                                     |                      |                      |
| Accounts receivables <sup>(5)</sup>                | \$ 243               | \$ 243               |
| <b>Liabilities:</b>                                |                      |                      |
| Long-term debt (excluding Cash Conversion Option)  | \$ 1,498             | \$ 1,585             |
| Project debt                                       | \$ 643               | \$ 656               |

- (1) 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.
- (2) Included in other noncurrent assets in the condensed consolidated balance sheets.
- (3) Included in prepaid expenses and other current assets in the condensed consolidated balance sheets.
- (4) Included in investments in fixed maturities at market in the condensed consolidated balance sheets.
- (5) Includes \$17 million of noncurrent receivables in other noncurrent assets in the condensed consolidated balance sheets.

**Table of Contents****COVANTA HOLDING CORPORATION AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

The following table presents information about the fair value measurement of our assets and liabilities as of December 31, 2011:

| Financial Instruments Recorded at Fair Value on a Recurring Basis:     | As of December 31, 2011 |                      | Fair Value Measurements at Reporting Date Using                                 |   |   |
|--|-------------------------|----------------------|---|---|---|
|  | Carrying Amount         | Estimated Fair Value | Quoted Prices in Active Markets for Identical Assets (Level 1)<br>(In millions) | Significant Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| <b>Assets:</b>   |                         |                      |   |   |   |
| Cash and cash equivalents:   |                         |                      |   |   |   |
| Bank deposits and certificates of deposit                              | \$ 225                  | \$ 225               | \$ 225  | \$                                      | \$  |
| Money market funds   | 7                       | 7                    | 7   |   |   |
| <b>Total cash and cash equivalents:</b>                                | <b>232</b>              | <b>232</b>           | <b>232</b>  |   |   |
| Restricted funds held in trust:  |                         |                      |   |   |   |
| Bank deposits and certificates of deposit                              | 5                       | 5                    | 5   |   |   |
| Money market funds   | 119                     | 119                  | 119   |   |   |
| U.S. Treasury/Agency obligations <sup>(1)</sup>                        | 15                      | 15                   | 15  |   |   |
| State and municipal obligations  | 7                       | 7                    | 7   |   |   |
| Commercial paper/Guaranteed investment contracts/Repurchase agreements | 45                      | 45                   | 45  |   |   |
| <b>Total restricted funds held in trust:</b>                           | <b>191</b>              | <b>191</b>           | <b>191</b>  |   |   |
| Restricted funds other:  |                         |                      |   |   |   |
| Bank deposits and certificates of deposit <sup>(2)(3)</sup>            | 5                       | 5                    | 5   |   |   |
| Money market funds <sup>(3)</sup>                                      | 7                       | 7                    | 7   |   |   |
| Residential mortgage-backed securities <sup>(3)</sup>                  | 1                       | 1                    | 1   |   |   |
| <b>Total restricted funds other:</b>                                   | <b>13</b>               | <b>13</b>            | <b>13</b>   |   |   |
| Investments:   |                         |                      |   |   |   |
| Mutual and bond funds <sup>(2)</sup>                                   | 2                       | 2                    | 2   |   |   |
| Investments available for sale:  |                         |                      |   |   |   |
| U.S. Treasury/Agency obligations <sup>(4)</sup>                        | 8                       | 8                    | 8   |   |   |
| Residential mortgage-backed securities <sup>(4)</sup>                  | 7                       | 7                    | 7   |   |   |
| Other government obligations <sup>(4)</sup>                            | 3                       | 3                    | 3   |   |   |
| Corporate investments <sup>(4)</sup>                                   | 13                      | 13                   | 13  |   |   |
| Equity securities <sup>(3)</sup>                                       | 1                       | 1                    | 1   |   |   |
| <b>Total investments:</b>  | <b>34</b>               | <b>34</b>            | <b>34</b>   |   |   |
| Derivative Asset Note Hedge  | 47                      | 47                   |   | 47                                      |   |
| Derivative Asset Energy Hedges   | 3                       | 3                    |   | 3                                       |   |
| <b>Total assets:</b>   | <b>\$ 520</b>           | <b>\$ 520</b>        | <b>\$ 470</b>   | <b>\$ 50</b>                            | <b>\$</b>                                 |

**Liabilities:**

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|                           |  |           |           |           |           |           |           |           |
|---------------------------|--|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| Derivative Liability      | Cash Conversion Option   | \$        | 49        | \$        | 49        | \$        | 49        | \$        |
| Derivative Liabilities    | Contingent interest features of the 3.25% Notes and Debentures |           | 0         |           | 0         |           | 0         |           |
| <b>Total liabilities:</b> |  | <b>\$</b> | <b>49</b> | <b>\$</b> | <b>49</b> | <b>\$</b> | <b>49</b> | <b>\$</b> |

| <b>Financial Instruments Recorded at Carrying Amount:</b> | <b>As of December 31, 2011</b> |                             |
|---|--------------------------------|-----------------------------|
|   | <b>Carrying Amount</b>         | <b>Estimated Fair Value</b> |
| <b>Assets:</b>  |                                |                             |
| Accounts receivables <sup>(5)</sup>                       | \$ 277                         | \$ 277                      |
| <b>Liabilities:</b>                                       |                                |                             |
| Long-term debt (excluding Cash Conversion Option)         | \$ 1,437                       | \$ 1,470                    |
| Project debt  | \$ 680                         | \$ 693                      |

- (1) 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.
- (2) Included in other noncurrent assets in the condensed consolidated balance sheets.
- (3) Included in prepaid expenses and other current assets in the condensed consolidated balance sheets.
- (4) Included in investments in fixed maturities at market in the condensed consolidated balance sheets.
- (5) Includes \$17 million of noncurrent receivables in other noncurrent assets in the condensed consolidated balance sheets.

**Table of Contents****COVANTA HOLDING CORPORATION AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)****Investments**

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 securities values are determined by pricing based on the last day's trading activity. Changes in fair values are credited or charged directly to Accumulated Other Comprehensive Income (AOCI) in the condensed consolidated statements of comprehensive income 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 operations based on the amortized cost of fixed maturities and the 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 operations to the extent they relate to credit losses, and to AOCI to the extent they are related to other factors. The cost basis of the security is also 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 that do not have readily determinable fair values, are carried at the lower of cost or estimated realizable value.

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

|   | As of March 31, 2012            |                    |                    |               | As of December 31, 2011         |                    |                    |               |
|---|---------------------------------|--------------------|--------------------|---------------|---------------------------------|--------------------|--------------------|---------------|
|   | Cost<br>or<br>Amortized<br>Cost | Unrealized<br>Gain | Unrealized<br>Loss | Fair<br>Value | Cost<br>or<br>Amortized<br>Cost | Unrealized<br>Gain | Unrealized<br>Loss | Fair<br>Value |
| <b>Current investments:</b>                 |                                 |                    |                    |               |                                 |                    |                    |               |
| Fixed maturities                            | \$                              | \$                 | \$                 | \$            | \$                              | \$                 | \$                 | \$            |
| Equity securities - insurance business      | 1                               |                    |                    | 1             | 1                               |                    |                    | 1             |
| <b>Total current investments</b>            | <b>\$ 1</b>                     | <b>\$</b>          | <b>\$</b>          | <b>\$ 1</b>   | <b>\$ 1</b>                     | <b>\$</b>          | <b>\$</b>          | <b>\$ 1</b>   |
| <b>Noncurrent investments:</b>              |                                 |                    |                    |               |                                 |                    |                    |               |
| Fixed maturities - insurance business:      |                                 |                    |                    |               |                                 |                    |                    |               |
| U.S. government obligations                 | \$                              | \$                 | \$                 | \$            | \$                              | \$                 | \$                 | \$            |
| U.S. government agencies                    | 7                               |                    |                    | 7             | 8                               |                    |                    | 8             |
| Residential mortgage-backed securities      | 7                               |                    |                    | 7             | 7                               |                    |                    | 7             |
| Other government obligations                | 3                               |                    |                    | 3             | 3                               |                    |                    | 3             |
| Corporate investments                       | 13                              | 1                  |                    | 14            | 13                              |                    |                    | 13            |
| Total fixed maturities - insurance business | 30                              | 1                  |                    | 31            | 31                              |                    |                    | 31            |
| Mutual and bond funds                       | 2                               |                    |                    | 2             | 2                               |                    |                    | 2             |

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**Total noncurrent investments**                      \$ 32      \$ 1      \$              \$ 33      \$ 33      \$              \$              \$ 33

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

| Description of Investments                                 | As of March 31, 2012 |                   | As of December 31, 2011 |                   |
|--|----------------------|-------------------|-------------------------|-------------------|
|  | Fair Value           | Unrealized Losses | Fair Value              | Unrealized Losses |
| U.S. Treasury and other direct U.S. Government obligations | \$ 1                 | \$                | \$                      | \$                |
| Residential mortgage-backed securities                     | 4                    |                   | 4                       |                   |
| Other government obligations                               | 1                    |                   | 1                       |                   |
| Corporate bonds  | 2                    |                   | 6                       |                   |
| <b>Total fixed maturities</b>                              | <b>8</b>             |                   |                         |                   |