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DANIELSON HOLDING CORP
Form 10-Q/A
May 18, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q/A

Amendment No. 1

(X) QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2004

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: 1-6732

DANIELSON HOLDING CORPORATION
(Exact Name of Registrant as Specified in its Charter)

DELAWARE
(State or Other Jurisdiction of
Incorporation or Organization)

95-6021257
(I.R.S. Employer
Identification No.)

TWO NORTH RIVERSIDE PLAZA, SUITE 600
CHICAGO, IL
(Address of Principal Executive Offices)

60606
(Zip Code)

(312) 466-4030
(Registrant's Telephone Number, Including Area Code)

(Former Name, Former Address and Former Fiscal Year,
if Changed Since Last Report)

Indicate by check mark whether 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 registrant
was required to file such reports), and (2) has been subject to such filing
requirements for the past 90 days.

Yes X No

Indicate by check mark whether registrant is an accelerated filer (as
defined in Rule 12b-2 of the Exchange Act).

Yes X No

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Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

| CLASS | OUTSTANDING AT MAY 7, 2004 |
|--------------------------------|----------------------------|
| Common Stock, \$0.10 par value | 35,964,145 shares |

EXPLANATORY NOTE: The purpose of this amendment is to amend and restate in its entirety Part I, Item 1 in order to correct a computational arithmetic error in the consolidated statements of financial position, a computational error in the formula calculating the foreign income taxes in the pro forma information contained in Note 2, and to supplement the exhibits filed under Part II, Item 6(a) of the Quarterly Report on Form 10-Q for Danielson Holding Corporation as filed with the Securities and Exchange Commission on May 7, 2004 for the quarterly period ended March 31, 2004. This Form 10-Q/A does not reflect events occurring after the filing of the original Form 10-Q, or modify or update the disclosures therein in any way other than as required to reflect these changes.

DANIELSON HOLDING CORPORATION
FORM 10-Q QUARTERLY REPORT
FOR THE QUARTER ENDED MARCH 31, 2004

PART I

Item 1. Financial Statements

| | |
|---|-------|
| Condensed Consolidated Statements of Operations for the Quarters Ended March 31, 2004 and March 28, 2003 (Unaudited)..... | |
| Condensed Consolidated Statements of Financial Position as of March 31, 2004 (Unaudited) and December 31, 2003..... | |
| Condensed Consolidated Statement of Stockholders' Equity for the Quarter Ended March 31, 2004 (Unaudited)..... | |
| Condensed Consolidated Statements of Cash Flows for the Quarters Ended March 31, 2004 and March 28, 2003 (Unaudited)..... | |
| Notes to Condensed Consolidated Financial Statements (Unaudited)..... | |

| | |
|---|-------|
| Item 6. Exhibits and Reports on Form 8-K..... | |
|---|-------|

OTHER

| | |
|--|-------|
| Signatures..... | |
| Exhibit 31.1 CEO Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002..... | |
| Exhibit 31.2 CFO Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002..... | |
| Exhibit 32.1 CEO Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002..... | |
| Exhibit 32.2 CFO Certification Pursuant to 18 U.S.C. Section 1350, as Adopted | |

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Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.....

DANIELSON HOLDING CORPORATION
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
 (UNAUDITED)
 (DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

| | QUARTERS ENDED | |
|--|-------------------|-------------------|
| | MARCH 31, 2004 | MARCH 28, 2003 |
| ENERGY AND WATER: | | |
| OPERATING REVENUES: | | |
| Service Revenues | \$ 25,453 | \$ -- |
| Electricity and Steam Sales | 13,521 | -- |
| Other | 2 | -- |
| | 38,976 | -- |
| | | |
| OPERATING EXPENSES: | | |
| Plant Operating Expenses | 27,322 | -- |
| Construction Costs | -- | -- |
| Depreciation and Amortization | 3,495 | -- |
| Debt Service Charges, Net | 2,237 | -- |
| Other Operating Costs and Expenses | 12 | -- |
| Selling, General and Administrative Expenses | 1,596 | -- |
| Other | (198) | -- |
| | 34,464 | -- |
| Total Energy and Water Operating Expenses | | |
| | 4,512 | -- |
| | | |
| | | |
| INSURANCE SERVICES: | | |
| OPERATING REVENUES: | | |
| Gross Earned Premiums | 6,321 | 11,096 |
| Ceded Earned Premiums | (333) | (744) |
| | 5,988 | 10,352 |
| Net Earned Premiums | | |
| Net Investment Income | 722 | 1,162 |
| Net Realized Investment Gains (Losses) | 171 | (548) |
| Other Income | 18 | 110 |
| | 6,899 | 11,076 |
| Total Insurance Services' Operating Revenues | | |
| | | |
| OPERATING EXPENSES: | | |
| Gross Losses and Loss Adjustment Expenses | 4,311 | 10,416 |
| Ceded Losses and Loss Adjustment Expenses | (28) | (1,227) |
| | 4,283 | 9,189 |
| Net Losses and Loss Adjustment Expenses | | |

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| | | |
|---|-------|---------|
| Policy Acquisition Expenses | 1,215 | 2,636 |
| General and Administrative | 1,297 | 1,034 |
| | ----- | ----- |
| Total Insurance Services' Operating Expenses | 6,795 | 12,859 |
| | ----- | ----- |
| Operating Income (Loss) from Insurance Services | 104 | (1,783) |
| | ----- | ----- |

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

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DANIELSON HOLDING CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS - (CONTINUED)
(UNAUDITED)
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

| | QUARTERS ENDED | |
|--|-------------------|-------------------|
| | MARCH 31, 2004 | MARCH 28, 2003 |
| | ----- | ----- |
| PARENT COMPANY: | | |
| Net Investment Income | 86 | 134 |
| Net Realized Investment Gains | -- | 530 |
| Administrative Expenses | (779) | (1,531) |
| | ----- | ----- |
| Operating Loss from Parent Company | (693) | (867) |
| | ----- | ----- |
| Operating Income (Loss) | 3,923 | (2,650) |
| | ----- | ----- |
| OTHER INCOME (EXPENSES): | | |
| Interest Expense | (6,922) | -- |
| Equity in Net Income (Loss) of Unconsolidated Investments | 1,015 | (55,174) |
| | ----- | ----- |
| Total Other Expenses | (5,907) | (55,174) |
| | ----- | ----- |
| Loss Before Minority Interests and Provision for Income Taxes | (1,984) | (57,824) |
| | ----- | ----- |
| INCOME TAX PROVISION (BENEFIT) | (368) | 12 |
| MINORITY INTERESTS, ENERGY AND WATER | (557) | -- |
| | ----- | ----- |
| Net Loss | \$ (2,173) | \$ (57,836) |
| | ===== | ===== |
| LOSS PER SHARE OF COMMON STOCK - BASIC | \$ (0.07) | \$ (1.88) |
| | ===== | ===== |

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| | | |
|--|-----------|-----------|
| LOSS PER SHARE OF COMMON STOCK - DILUTED | \$ (0.07) | \$ (1.88) |
| | ===== | ===== |

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

2

DANIELSON HOLDING CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
(DOLLARS IN THOUSANDS)

ASSETS

ENERGY AND WATER ASSETS:

Current:

| | |
|---------------------------------------|----|
| Cash and Cash Equivalents | \$ |
| Restricted Funds Held in Trust | |
| Receivables (Less Allowances of \$45) | |
| Deferred Income Taxes | |
| Prepaid Expenses and Other | |

Total Current Assets

| | |
|---|---|
| Property, Plant and Equipment, Net | 1 |
| Restricted Funds Held in Trust | |
| Unbilled Service and Other Receivables | |
| Service and Energy Contracts (Net of Accumulated Amortization of \$1,407) | |
| Goodwill | |
| Investments In and Advances to Investees and Joint Ventures | |
| Other Assets | |

Total Energy and Water Assets 2

PARENT COMPANY'S AND INSURANCE SERVICES' ASSETS:

| | |
|--|--|
| Cash and Cash Equivalents | |
| Restricted Cash, Covanta Escrow | |
| Investments: | |
| Fixed Maturities, Available for Sale at Fair Value (Cost: \$61,288 and \$69,840) | |
| Equity Securities, Available for Sale at Fair Value (Cost: \$367 and \$367) | |
| Accrued Investment Income | |
| Premium and Consulting Receivables, Net of Allowances of \$457 and \$462 | |
| Reinsurance Recoverable on Paid Losses, Net of Allowances of \$1,951 and \$1,898 | |
| Reinsurance Recoverable on Unpaid Losses, Net of Allowances of \$252 and \$237 | |
| Ceded Unearned Premiums | |
| Properties, Net | |
| Investments in Unconsolidated Marine Services Subsidiaries | |
| Deferred Financing Costs (Net of Amortization of \$4,097 and \$1,024) | |
| Deferred Income Taxes | |

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Other Assets

Total Parent Company's and Insurance Services' Assets

Total Assets

\$ 2
=====

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

3

DANIELSON HOLDING CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION - (CONTINUED)
(DOLLARS IN THOUSANDS)

(UNAUDITED)
MARCH
200

LIABILITIES AND STOCKHOLDERS' EQUITY

ENERGY AND WATER LIABILITIES:

Current:

| | | |
|-----------------------------------|----|----|
| Current Portion of Long-term Debt | \$ | |
| Current Portion of Project Debt | | 9 |
| Accounts Payable | | 2 |
| Federal Income Taxes Payable | | |
| Accrued Expenses | | 18 |
| Deferred Income | | 3 |

Total Current Liabilities 34

| | | |
|-----------------------|--|----|
| Long-term Debt | | 33 |
| Project Debt | | 84 |
| Deferred Income Taxes | | 31 |
| Deferred Income | | 12 |
| Other Liabilities | | 12 |

Total Energy and Water Liabilities 2,09

PARENT COMPANY'S AND INSURANCE SERVICES' LIABILITIES:

| | | |
|--|--|---|
| Unpaid Losses and Loss Adjustment Expenses | | 7 |
| Unearned Premiums | | |
| Interest Payable | | |
| Parent Company Debt Payable to Related Parties | | 4 |
| Bank Overdraft | | |
| Other Liabilities | | |

Total Parent Company's and Insurance Services' Liabilities 12

Total Liabilities 2,22

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MINORITY INTERESTS, ENERGY AND WATER

STOCKHOLDERS' EQUITY:

Preferred Stock (\$0.10 par value; authorized 10,000,000 shares; none issued and outstanding)
 Common Stock (\$0.10 par value; authorized 150,000,000 shares; issued 35,969,941 and 35,793,440 shares; outstanding 35,959,145 and 35,782,644 shares)
 Additional Paid-in Capital
 Unearned Compensation
 Accumulated Other Comprehensive Loss
 Accumulated Deficit
 Treasury Stock (Cost of 10,796 shares)

Total Stockholders' Equity

Total Liabilities and Stockholders' Equity

7
13
(10)

3

\$ 2,33
=====

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

4

DANIELSON HOLDING CORPORATION
 CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
 FOR THE QUARTER ENDED MARCH 31, 2004
 (UNAUDITED)
 (IN THOUSANDS)

| | COMMON STOCK | | ADDITIONAL PAID-IN CAPITAL | UN COMP |
|---|--------------|----------|----------------------------------|------------|
| | SHARES | AMOUNT | | |
| Balance at December 31, 2003 | 35,793,440 | \$ 3,579 | \$ 123,446 | \$ |
| Stock Option Compensation Expense | | | 10 | |
| Amortization of Unearned Compensation | | | | |
| Exercise of Options to Purchase Common Stock | 176,501 | 18 | 677 | |
| Stock Purchase Rights Issued to Covanta Creditors (Note 2) | | | 11,300 | |
| Comprehensive (Loss): | | | | |
| Net Loss | | | | |
| Foreign Currency Translation | | | | |
| Net Unrealized (Loss) on Available for Sale Securities | | | | |
| Total Comprehensive Income (Loss) | | | | |
| Balance at March 31, 2004 | 35,969,941 | \$ 3,597 | \$ 135,433 | \$ |

| RETAINED (DEFICIT) | TREASURY STOCK | |
|-----------------------|----------------|--------|
| | SHARES | AMOUNT |
| ----- | ----- | ----- |

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| | | | | | | |
|--|----|-----------|--------|----|-------|-------|
| Balance at December 31, 2003 | \$ | (98,434) | 10,796 | \$ | (66) | \$ |
| Stock Option Compensation Expense | | | | | | |
| Amortization of Unearned Compensation | | | | | | |
| Exercise of Options to Purchase Common Stock | | | | | | |
| Stock Purchase Rights Issued to Covanta Creditors (Note 2) | | | | | | |
| Comprehensive (Loss): | | | | | | |
| Net Loss | | (2,173) | | | | |
| Foreign Currency Translation | | | | | | |
| Net Unrealized (Loss) on Available for Sale Securities | | | | | | |
| | | ----- | | | | |
| Total Comprehensive Income (Loss) | | (2,173) | | | | |
| | | ----- | | | | |
| Balance at March 31, 2004 | \$ | (100,607) | 10,796 | \$ | (66) | \$ |
| | | ===== | ===== | | ===== | ===== |

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

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DANIELSON HOLDING CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)
(DOLLARS IN THOUSANDS)

| | | QUARTER ----- MARCH 31, 2004 ----- |
|---|----|--|
| OPERATING ACTIVITIES | | |
| Net Loss | \$ | (2,173) |
| Adjustments to Reconcile Net Loss to Net Cash (Used in) Operating Activities: | | |
| Net (Gain) Loss on Investment Securities | | (171) |
| Depreciation and Amortization | | 3,581 |
| Amortization of Deferred Financing Costs | | 3,073 |
| Provision for Doubtful Accounts | | 46 |
| Stock Option and Unearned Compensation Expense | | 61 |
| Interest Accretion and Amortization | | 18 |
| Equity in Net (Income) Loss of Unconsolidated Marine Services Subsidiaries | | (83) |
| Equity in Net (Loss) of Water and Energy Subsidiaries | | (932) |
| Deferred Tax Asset | | (1,625) |
| Change in Operating Assets and Liabilities, Net of Effects of Acquisition: | | |
| Accrued Investment Income | | 327 |
| Receivables | | 7,959 |
| Premium and Consulting Receivables | | 881 |
| Reinsurance Recoverable on Paid Losses | | 18 |
| Reinsurance Recoverable on Unpaid Losses | | 659 |
| Ceded Unearned Premiums | | 344 |
| Other Assets | | 5,419 |
| Unpaid Losses and Loss Adjustment Expenses | | (5,935) |
| Unearned Premiums | | (2,339) |
| Accounts Payable | | (385) |
| Accrued Expenses | | (23,248) |

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| | |
|--|------------|
| Deferred Income | (167) |
| Interest Payable | 1,200 |
| Other Liabilities | (3,693) |
| Other, Net | (449) |
| | ----- |
| Net Cash (Used in) Operating Activities | (17,614) |
| | ----- |
| INVESTING ACTIVITIES | |
| Property Additions | (1,234) |
| Decrease in Restricted Cash, Covanta Escrow | 37,026 |
| Purchase of Covanta | (36,400) |
| Cash Acquired of Covanta | 95,462 |
| Collection of Notes Receivable from Affiliate | -- |
| Proceeds from the Sale of Investment Securities | -- |
| Matured or Called Investment Securities | 16,583 |
| Purchase of Investment Securities | (7,910) |
| Distribution Received from Investees and Joint Ventures | 632 |
| Distribution Received from Unconsolidated Marine Services Subsidiary | -- |
| | ----- |
| Net Cash Provided by Investing Activities | 104,159 |
| | ----- |
| FINANCING ACTIVITIES | |
| Bank Overdrafts | (820) |
| Proceeds from the Exercise of Options for Common Stock | 694 |
| Debt Repayments | (175) |
| Distribution to Minority Partners | (428) |
| Proceeds from Sale of Minority Interests | 25 |
| Decrease in Restricted Funds Held in Trust | 8,210 |
| Parent Company Debt Issue Costs | (300) |
| | ----- |
| Net Cash Provided by Financing Activities | 7,206 |
| | ----- |
| Net Increase (Decrease) in Cash and Cash Equivalents | 93,751 |
| Cash and Cash Equivalents at Beginning of Period | 17,952 |
| | ----- |
| Cash and Cash Equivalents at End of Period | \$ 111,703 |
| | ===== |
| SUPPLEMENTAL INFORMATION: | |
| Cash Paid During the Period For: | |
| Interest | 804 |
| Income Taxes | 1,696 |

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

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DANIELSON HOLDING CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)
MARCH 31, 2004

NOTE 1. BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements

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of Danielson Holding Corporation ("DHC" or the "Company") have been prepared in accordance with the instructions to Form 10-Q. As permitted by the rules and regulations of the Securities and Exchange Commission (the "SEC"), the financial statements contain certain condensed financial information and exclude certain footnote disclosures normally included in audited consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). In the opinion of management, the accompanying financial statements contain all adjustments, including normal recurring accruals, necessary to fairly present the accompanying financial statements. For further information, refer to the consolidated financial statements and footnotes thereto included in DHC's Annual Report on Form 10-K for the year ended December 31, 2003. Operating results for the interim period are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2004.

DHC is a holding company that owns subsidiaries engaged in a number of diverse business activities. The most significant of these are the energy and water businesses of Covanta Energy Corporation ("Covanta") acquired on March 10, 2004. DHC also has investments in subsidiaries engaged in the insurance operations in the western United States, primarily California, and in American Commercial Lines LLC ("ACL"), an integrated marine transportation and service company currently in bankruptcy proceedings under Chapter 11 of the United States Bankruptcy Code (the "Bankruptcy Code").

Covanta develops, constructs, owns and operates for others, key infrastructure for the conversion of waste to energy, independent power production and the treatment of water and waste water in the United States and abroad. On March 10, 2004, Covanta consummated a plan of reorganization and except for six subsidiaries, emerged from its reorganization proceeding under Chapter 11 of the Bankruptcy Code ("Chapter 11"). Pursuant to the plan of reorganization, DHC acquired 100% of the equity in Covanta. This transaction is more fully described in Note 2. Six of Covanta's subsidiaries have not reorganized or filed a liquidation plan under the Bankruptcy Code. While Covanta exercises significant influence over the operating and financial policies of those subsidiaries. Those six subsidiaries will continue to operate as debtors in possession in the Chapter 11 cases. Because any plan of reorganization or liquidation relating to these debtors would have to be approved by the Bankruptcy Court, and possibly their respective creditors. Neither the Company nor Covanta controls these debtors or the ultimate outcome of their respective Chapter 11 cases relating to these debtors. Accordingly, applicable accounting rules require that Covanta no longer include those six subsidiaries as consolidated subsidiaries in its financial statements. Covanta's investment in these six subsidiaries are recorded using the equity method effective as of March 10, 2004.

DHC holds all of the voting stock of Danielson Indemnity Company ("DIND"). DIND owns 100% of the common stock of National American Insurance Company of California, DHC's principal operating insurance subsidiary, which owns 100% of the common stock of Valor Insurance Company, Incorporated ("Valor"). National American Insurance Company of California and its subsidiaries are collectively referred to herein as "NAICC". The operations of NAICC are in property and casualty insurance. NAICC writes non-standard private passenger insurance in the western United States, primarily California. Effective September 7, 2003, NAICC discontinued writing all commercial automobile insurance. Effective January 2002, NAICC discontinued writing all workers' compensation insurance.

ACL provides barge transportation and ancillary services throughout the inland United States and Gulf Intracoastal Waterway Systems, which include the Mississippi, Ohio and Illinois Rivers and their tributaries and the Intracoastal canals that parallel the Gulf Coast. In addition, ACL provides barge transportation services on the Orinoco River in Venezuela and the

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Parana/Paraguay River System serving Argentina, Brazil, Paraguay, Uruguay and Bolivia. As discussed in Note 3, on April 23, 2004, ACL sold its interest in UABL Limited, a South American barging and terminalling company.

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DANIELSON HOLDING CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)
MARCH 31, 2004

In May 2002, DHC acquired a 100% ownership interest in ACL, thereby entering into the marine transportation, construction and related service provider businesses. On January 31, 2003, ACL and many of its subsidiaries and its immediate direct parent entity, American Commercial Lines Holdings, LLC, referred to herein as "ACL Holdings," filed a petition with the U.S. Bankruptcy Court to reorganize under Chapter 11 of the Bankruptcy Code. Material uncertainty exists as to the impact of the bankruptcy on DHC's equity interest in ACL upon the conclusion of ACL's bankruptcy proceeding. While it cannot presently be determined, DHC believes that its investment in ACL is likely to have little or no value upon the completion of that bankruptcy proceeding. Accordingly, DHC attributes no value to its investment in ACL on its financial statements. DHC, NAICC and DHC's equity investees, operating in the marine services industries, are not guarantors of ACL's debt, nor are they contractually liable for any of ACL's liabilities.

As a result of the bankruptcy filing, while DHC continues to exercise influence over the operating and financial policies of ACL through its ownership of all of the equity interests in ACL, DHC no longer maintains control of ACL. Accordingly, for the year ended December 31, 2003, DHC has accounted for its investments in ACL, Global Materials Services, LLC ("GMS") and Vessel Leasing, LLC ("Vessel Leasing") using the equity method of accounting. Under the equity method of accounting, DHC reports its share of the equity investees' income or loss based on its ownership interest.

SZ Investments, L.L.C., a significant stockholder of DHC's, and a company affiliated with Samuel Zell, DHC's Chairman of the Board of Directors, William Pate, a member of DHC's Board of Directors and Philip Tinkler, DHC's Chief Financial Officer, is a holder through its affiliate, HY I Investments, L.L.C., of approximately 42% of ACL's senior notes and payment-in-kind notes. As a result, a special committee of DHC's Board of Directors was formed in November 2002, composed solely of disinterested directors, to oversee DHC's investment in ACL and its related Chapter 11 bankruptcy proceedings.

Covanta is referred to herein as "Energy and Water Services" or as "Covanta". DHC's insurance subsidiaries are referred to herein as "Insurance Services". ACL, GMS and Vessel Leasing are together referred to herein as "Marine Services".

The December 31, 2003 consolidated financial statements include the accounts of DHC and DIND and their consolidated subsidiaries. The March 31, 2004 consolidated financial statements include the accounts of DHC, DIND and Covanta and their consolidated subsidiaries. All intercompany accounts and transactions have been eliminated. As previously mentioned, DHC's investments in ACL and its consolidated subsidiaries, GMS and Vessel Leasing, are included in the quarter ended March 31, 2004 consolidated financial statements using the equity method of accounting.

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The accompanying consolidated statement of financial position at December 31, 2003 has been derived from the audited consolidated financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements.

NOTE 2. COVANTA ACQUISITION AND FINANCING AGREEMENTS

On December 2, 2003, DHC executed a definitive investment and purchase agreement to acquire Covanta in connection with Covanta's emergence from Chapter 11 proceedings in bankruptcy after the non-core and geothermal assets of Covanta were divested. The primary components of the transaction were: (1) the purchase by DHC of 100% of the equity of Covanta in consideration for a cash purchase price of approximately \$30 million, and (2) agreement as to new letter of credit and revolving credit facilities for Covanta's domestic and international operations, provided by some of the existing Covanta lenders and a group of additional lenders organized by DHC.

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DANIELSON HOLDING CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)
MARCH 31, 2004

As required by the investment and purchase agreement, Covanta filed a proposed plan of reorganization, a proposed plan of liquidation for specified non-core businesses, and the related draft disclosure statement, each reflecting the transactions contemplated under the investment and purchase agreement, with the Bankruptcy Court. On March 5, 2004, the Bankruptcy Court confirmed the proposed plans (the "Reorganization Plan"). On March 10, 2004, DHC acquired 100% of Covanta's equity in consideration for approximately \$30 million.

With the purchase of Covanta, DHC acquired a leading provider of waste to energy services, independent power production and water and wastewater treatment services in the United States and abroad. DHC's equity investment and ownership provided Covanta's businesses with improved liquidity and capital resources to finance their business activities and emerge from bankruptcy. Management believes that these factors will enable DHC to earn an attractive return on its investment.

The aggregate purchase price was \$47.5 million which includes the cash purchase price of \$29.8 million, approximately \$6.4 million for professional fees and other estimated costs incurred in connection with the acquisition, and an estimated fair value of \$11.3 million for DHC's commitment to sell up to 3 million shares of its common stock at \$1.53 per share to certain creditors of Covanta, subject to certain limitations as more fully described below.

The following table summarizes a preliminary allocation of values to the assets acquired and liabilities assumed at the date of acquisition in conformity with Statement of Financial Accounting Standards (SFAS) No. 141 "Business Combinations" and SFAS No. 109 "Accounting for Income Taxes". In addition to purchase price allocation adjustments, Covanta's emergence from Chapter 11 proceedings on March 10, 2004 resulted in a new reporting entity and adoption of fresh start accounting as of that date, in accordance with AICPA Statement of Position (SOP) 90-7, "Financial Reporting by Entities in Reorganization Under Bankruptcy Code". Preliminary fair value determinations of the tangible and intangible assets are based on discounted cash flows using

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currently available information. The excess of the reorganization value over tangible assets and identifiable intangible assets has been reflected as goodwill. Management's estimate of the fair value of long term debt was based on the new principal amounts of recourse debt that was part of the reorganized capital structure of Covanta upon emergence. The Company has engaged valuation consultants to review its valuation methodology and their work is ongoing. Changes in the fair values of these assets from the current estimated values as well as changes in other assumptions could significantly impact the reported value of goodwill. The summary balance sheet information that follows reflects:

- (i) reduction of Covanta's property, plant and equipment carrying values;
- (ii) increase in the carrying value of the Covanta's various operation and maintenance agreements and power purchase agreements;
- (iii) forgiveness of the Covanta's pre-petition debt;
- (iv) issuance of new common stock to DHC and other items in equity and notes pursuant to the plan;
- (v) payment of various administrative and other claims associated with the Covanta's emergence from Chapter 11;
- (vi) distribution of cash of \$235.5 million to the Covanta's pre-petition secured lenders and for the payment of exit costs and funding of reserves;
- (vii) deferred tax assets of approximately \$91.7 million principally related to net operating loss carryforwards ("NOLs") from the inclusion of Covanta in DHC's consolidated Federal income tax group; and
- (viii) additional costs and expense related to DHC's acquisition of Covanta.

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These adjustments were based upon the preliminary work of the Company and its financial consultants, as well as other valuation estimates, to determine the relative fair values of Covanta's assets and liabilities. Accordingly, the allocation of purchase price is subject to refinement.

The following depicts the summary balance sheet of Covanta as of March 10, 2004 (in thousands):

| | |
|-------------------------------|------------|
| Current Assets | \$ 529,923 |
| Property, Plant and Equipment | 1,034,779 |
| Intangible Assets | 318,114 |
| Goodwill | 24,470 |
| Other Assets | 329,743 |

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| | |
|---------------------------|--------------|
| Total Assets Acquired | \$ 2,237,029 |
| Current Liabilities | \$ 371,618 |
| Long-term Debt | 337,761 |
| Project Debt | 847,651 |
| Deferred Income Taxes | 305,784 |
| Other Liabilities | 326,690 |
| Total Liabilities Assumed | \$ 2,189,504 |
| Net Assets Acquired | \$ 47,525 |

The acquired intangible assets of \$318.1 million primarily relate to service agreements on publicly owned waste to energy projects with an approximate six-year weighted average useful life.

The \$24.5 million of goodwill is not expected to be deductible for income tax purposes. Approximately \$20.3 million of goodwill has been assigned to Covanta's domestic energy and water operations and \$4.2 million to the international energy operations of Covanta Power International Holdings, Inc. ("CPIH").

The results of operations from Covanta are included in DHC's consolidated results of operations from March 10, 2004. The following table sets forth certain unaudited consolidated operating results for the quarters ended March 31, 2004 and March 28, 2003, as if the acquisition of Covanta were consummated on the same terms at the beginning of each period (in thousands, except per share amounts).

| | 2004 | 2003 |
|--|------------|------------|
| Total Revenues | \$ 183,376 | \$ 196,48 |
| Income (Loss) from continuing operations before change in accounting principle | 3,227 | (29,67) |
| Cumulative effect of change in accounting principle | -- | (8,53) |
| Net Income (Loss) | \$ 3,227 | \$ (38,21) |
| Basic Income (Loss) per Share: | | |
| Income (loss) from Continuing Operations | \$ 0.09 | \$ (0.8 |
| Cumulative Effect of Accounting Change | -- | (0.2 |
| Net Income (Loss) per Share | \$ 0.09 | \$ (1.0 |
| Diluted Net Income (Loss) per Share | \$ 0.06 | \$ (1.0 |

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As part of the investment and purchase agreement, DHC arranged for a new \$118.0 million replacement letter of credit facility for Covanta, secured by a second lien on Covanta's domestic assets. This financing was provided by SZ Investments, L.L.C., a DHC stockholder ("SZ Investments"), Third Avenue Trust, on behalf of Third Avenue Value Fund Series, a DHC stockholder ("Third Avenue"), and D. E. Shaw Laminar Portfolios, L.L.C., a creditor of Covanta and a DHC stockholder ("Laminar"). In addition, in connection with a note purchase agreement described below, Laminar arranged for a \$10.0 million revolving loan facility for CPIH, secured by CPIH's assets.

DHC obtained the financing necessary for the Covanta acquisition pursuant to a note purchase agreement dated December 2, 2003, with each of SZ Investments, Third Avenue and Laminar, referred to collectively as the "Bridge Lenders". Pursuant to the note purchase agreement, the Bridge Lenders severally provided DHC with an aggregate of \$40 million of bridge financing in exchange for notes issued by DHC. In the event that DHC is unable to repay all or a portion of the notes with the proceeds from a rights offering of DHC common stock, then the notes are convertible without action by the Bridge Lenders into shares of DHC common stock at a price of \$1.53 per share subject to certain agreed upon limitations. These notes have a scheduled maturity date of January 2, 2005 and an extended maturity date of July 15, 2005, and bear interest at a rate of 12% per annum through July 15, 2004 and 16% per annum thereafter. In the event of a default or the failure to pay a note on its maturity, the interest rate under the note increases by 2% per annum. DHC used \$30.0 million of the proceeds from the notes to post an escrow deposit prior to the closing of the transactions contemplated by the investment and purchase agreement with Covanta. At closing, the deposit was used to purchase Covanta. DHC will use the remainder of the proceeds to pay transaction expenses and for general corporate purposes.

DHC issued to the Bridge Lenders an aggregate of 5,120,853 shares of DHC's common stock primarily in consideration for the \$40 million of bridge financing. At the time that DHC entered into the note purchase agreement, agreed to issue the notes convertible into shares of DHC common stock and issued the equity compensation to the Bridge Lenders, the trading price of the DHC common stock was below the \$1.53 per share conversion price of the notes. On December 1, 2003, the day prior to the announcement of the Covanta acquisition, the closing price of DHC common stock on the American Stock Exchange was \$1.40 per share.

In addition, under the note purchase agreement, Laminar has agreed to convert an amount of notes to acquire up to an additional 8.75 million shares of DHC common stock at \$1.53 per share based upon the levels of public participation in a previously announced rights offering. Further, DHC has agreed, in connection with the note purchase agreement, to sell up to an additional 3.0 million shares of DHC common stock at \$1.53 per share to certain creditors of Covanta based upon the levels of public participation in the rights offering and subject to change of ownership and other limitations.

As part of DHC's negotiations with Laminar and its becoming a 5% stockholder, pursuant to a letter agreement dated December 2, 2003, Laminar has agreed to additional restrictions on the transferability of the shares of DHC common stock that Laminar holds or will acquire. Further in accordance with the transfer restrictions contained in Article Fifth of DHC's charter restricting

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the resale of DHC common stock by 5% stockholders, DHC has agreed with Laminar to provide it with limited rights to resell the DHC common stock that it holds. Finally, DHC has agreed with the Bridge Lenders to file a registration statement with the SEC to register the shares of DHC common stock issued to or acquired by them under the note purchase agreement not later than the earlier of June 30, 2004 or ten days after closing of the rights offering.

Samuel Zell, DHC's Chairman of the Board of Directors, Philip Tinkler, DHC Chief Financial Officer and William Pate, a director of DHC, are affiliated with SZ Investments. Martin Whitman and David Barse, directors of DHC, are affiliated with Third Avenue. The note purchase agreement and other transactions involving the Bridge Lenders were negotiated, reviewed and approved by a special committee of DHC's Board of Directors composed solely of disinterested directors and advised by independent legal and financial advisors.

See Notes 9 through 11 for additional information regarding Covanta's credit and debt arrangements.

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NOTE 3. ACL CHAPTER 11 FILING

During 2002 and 2003, ACL experienced a decline in barging rates, reduced shipping volumes and excess barging capacity during a period of slow economic growth. Due to these factors, ACL's revenues and earnings did not meet expectations and ACL's liquidity was significantly impaired. Debt covenant violations occurred and, as a result, ACL was unable to meet its financial obligations as they became due. On January 31, 2003 (the "Petition Date"), ACL filed a petition with the U.S. Bankruptcy Court for the Southern District of Indiana, New Albany Division (the "Bankruptcy Court") to reorganize under Chapter 11 under case number 03-90305. Included in the filing are ACL, ACL's direct parent (American Commercial Lines Holdings LLC), American Commercial Barge Line LLC, Jeffboat LLC, Louisiana Dock Company LLC and ten other U.S. subsidiaries of ACL (collectively with ACL, the "Debtors") under case numbers 03-90306 through 03-90319. These cases are jointly administered for procedural purposes before the Bankruptcy Court under case number 03-90305. The Chapter 11 petitions do not cover any of ACL's foreign subsidiaries or certain of its U.S. subsidiaries.

ACL and the other Debtors are continuing to operate their businesses as debtors-in-possession under the jurisdiction of the Bankruptcy Court and in accordance with the applicable provisions of the Bankruptcy Code and orders of the Bankruptcy Court. As debtors-in-possession, the Debtors may not engage in transactions outside of the ordinary course of business without approval, after hearing, of the Bankruptcy Court. As part of the Chapter 11 cases, the Debtors intend to develop and propose for confirmation pursuant to Chapter 11, a plan of reorganization that will restructure the operations and liabilities of the Debtors to the extent necessary to result in the continuing viability of ACL. A filing date for such a plan has not been determined; however, the Debtors have the exclusive right to file a plan of reorganization at any time on or before May 28, 2004. If the exclusive filing period were to expire, other parties, such as ACL creditors, would have the right to propose alternative plans of reorganization. During the pendency of these Chapter 11 cases, the Debtors have

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routinely requested extension of the exclusivity period. Such extensions have been granted with the support of the Debtors' creditors. The Debtors intend to file for an additional extension of the exclusivity period to July 28, 2004.

The Debtors' direct and indirect foreign subsidiaries and foreign joint venture entities did not file petitions under Chapter 11 and are not debtors-in-possession. DHC, GMS and Vessel Leasing also did not file petitions under Chapter 11 and are not debtors-in-possession.

The Debtors have entered into a Revolving Credit and Guaranty Agreement ("DIP Credit Facility") that provides up to \$75 million of financing during ACL's Chapter 11 proceeding. As of December 26, 2003, participating bank commitments under the DIP Credit Facility totaled \$75 million, consisting of a \$50 million term loan and a \$25 million revolving credit facility. Of this amount, the Debtors had fully drawn the \$50 million term loan, which was used to retire ACL's Pre-Petition Receivables Facility and which continues to be used to fund the Debtors' day-to-day cash needs. The Debtors have made no draws against the revolving credit facility. In the first quarter of 2004, the Debtors repaid \$8 million of the term loan. Each payment permanently reduces the amount available under the DIP Credit Facility. As of March 31, 2004, participating bank commitments remaining under the DIP Credit Facility totaled \$67 million, consisting of \$42 million remaining on a fully-drawn term loan and a \$25 million revolving credit facility. Total amounts drawn under the DIP Credit Facility are limited by a borrowing base (as defined in the DIP Credit Facility). The borrowing base limit was \$56 million as of December 26, 2003 and is updated weekly. The DIP Credit Facility is secured by the same and additional assets that collateralized ACL's Senior Credit Facilities and Pre-Petition Receivables Facility, and bears interest, at ACL's option, at London Inter Bank Offered Rates ("LIBOR or LIBOR Rates") plus four percent or an Alternate Base Rate (as defined in the DIP Credit Facility) plus three percent. There are also certain interest rates in the event of a default under the facility.

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The obligations of the Debtors under the DIP Credit Facility, by court order, have super-priority administrative claim status as provided under the Bankruptcy Code. Under the Bankruptcy Code, a super-priority claim is senior to secured and unsecured pre-petition claims and all administrative expenses incurred in the Chapter 11 case. In addition, with certain exceptions (including a carve-out for unpaid professional fees and disbursements), the DIP Credit Facility obligations are secured by (1) a first-priority lien on all unencumbered pre- and post-petition property of the Debtors, (2) a first-priority priming lien on all property of the Debtors that is encumbered by the existing liens securing the Debtors' pre-petition secured lenders and (3) a junior lien on all other property of the Debtors that is encumbered by the pre-petition liens.

The DIP Credit Facility also contains certain restrictive covenants that, among other things, restrict the Debtors' ability to incur additional indebtedness or guarantee the obligations of others. ACL is also required to maintain minimum cumulative EBITDA, as defined in the DIP Credit Facility, limit its capital expenditures to defined levels and restrict advances to certain subsidiaries.

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The DIP Credit Facility will terminate and the borrowings thereunder will be due and payable upon the earliest of (i) July 31, 2004 (with borrowings repayable on August 2, 2004), (ii) the date of the substantial consummation of a plan of reorganization that is confirmed pursuant to an order by the Bankruptcy Court, or (iii) the acceleration of the term loans or the revolving credit loans made by any of the banks who are a party to the DIP Credit Facility and the termination of the total commitment under the DIP Credit Facility pursuant to the DIP Credit Facility.

As a result of the Chapter 11 filings, certain events of default under ACL's Senior Credit Facilities, Senior Notes, PIK Notes and Old Senior Notes have occurred, the effects of which are stayed pursuant to certain provisions of the Bankruptcy Code.

Under Chapter 11, actions by creditors to collect claims in existence at the filing date are stayed or deferred absent specific Bankruptcy Court authorization to pay such pre-petition claims while the Debtors continue to manage their businesses as debtors-in-possession and act to develop a plan of reorganization for the purpose of emerging from these proceedings. The Debtors have received approval from the Bankruptcy Court to pay or otherwise honor certain of its pre-petition obligations, including but not limited to employee wages and certain employee benefits, certain critical vendor payments, certain insurance and claim obligations and certain tax obligations as a plan of reorganization is developed. A claims bar date of December 5, 2003 was established for all other pre-petition creditors to file a claim against the estate of the various debtors. The Debtors are currently in the process of reviewing the claims that were filed against the Debtors. The ultimate amount of claims allowed by the Court against the Debtors could be significantly different than the amount of the liabilities recorded by the Debtors.

The Debtors also have numerous executory contracts and other agreements that could be assumed or rejected during the Chapter 11 proceedings. Parties affected by these rejections may file claims with the Bankruptcy Court in accordance with the reorganization process. Under these Chapter 11 proceedings, the rights of and ultimate payments to pre-petition creditors, rejection damage claimants and ACL's equity investor may be substantially altered. This could result in claims being liquidated in the Chapter 11 proceedings at less (possible substantially less) than 100% of their face value, and the membership interests of ACL's equity investor being diluted or cancelled. The Debtors have not yet proposed a plan of reorganization. The Debtors' pre-petition creditors and ACL's equity investor will each have a vote in the plan of reorganization.

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The Chapter 11 process presents inherent material uncertainty; it is not possible to determine the additional amount of claims that may arise or ultimately be filed, or predict the length of time that the Debtors will continue to operate under the protection of Chapter 11, the outcome of the Chapter 11 proceedings in general, whether the Debtors will continue to operate in their present organizational structure, or the effects of the proceedings on the business of ACL, the other Debtors and its non-filing subsidiaries and affiliates, or on the interests of the various creditors and equity holder. The

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ultimate recovery, if any, by creditors and DHC will not be determined until confirmation of a plan or plans of reorganization. No assurance can be given as to what value, if any, will be ascribed in the bankruptcy proceedings to each of these constituencies. While it cannot be presently determined, DHC believes it will receive little or no value with respect to its equity interest in ACL Holdings or ACL. Accordingly, DHC wrote off its remaining investment in ACL at the end of the first quarter of 2003 as an other than temporary asset impairment. (See Note 5)

On April 23, 2004, ACL announced the sale of its ownership interest in UABL Limited ("UABL"), a South American barging and terminalling company, and other assets being used by UABL for \$24.1 million of cash and other consideration. In connection with the UABL sale, ACL recorded a pre-tax loss of \$34.9 million.

NOTE 4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

PARENT AND CONSOLIDATED ENTITY

Principles of Consolidation

The consolidated financial statements reflect the results of operations, cash flows and financial position of DHC and its majority-owned and controlled subsidiaries. All intercompany accounts and transactions have been eliminated. Investments in companies that are not majority-owned or controlled are accounted for under the equity method.

Fiscal Year

In 2002, DHC conformed its previous calendar year-end reporting basis to ACL's fiscal year-end reporting basis. Effective with the fiscal year beginning December 28, 2002, DHC is again reporting on a calendar year-end basis to conform with DIND and its consolidated subsidiaries who have been consolidated in the accompanying consolidated financial statements using its calendar year-end reporting period in all periods presented.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents include short-term investments with a maturity of less than three months when purchased. DHC, from time to time, has cash in banks in excess of federally insured limits. Cash and cash equivalents are stated at cost, which approximates fair value.

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Deferred Financing Costs

The Company recorded \$18.8 million of deferred financing costs in connection with arranging its various financing arrangements. These costs are being amortized over the expected period that the related financing will be outstanding. Amortization for quarter ended March 31, 2004 was \$3.2 million and is included in interest expense on the consolidated statement of operations.

Incentive Compensation Plans

Stock-based compensation cost is measured using the intrinsic value based method of accounting prescribed by Accounting Principles Board Opinion No. 25 "Accounting for Stock Issued to Employees" ("APB 25") for the Company's directors and employees. Pro forma net loss and loss per share are disclosed below as if the fair value based method of accounting under SFAS 123 had been applied to all stock-based compensation awards.

| | (IN THOUSANDS) | |
|--------------------------------------|---------------------------------|---------------------------------|
| | QUARTER ENDED MARCH 31, 2004 | QUARTER ENDED MARCH 28, 2003 |
| | ----- | ----- |
| Stock Option Expense Recorded | \$ (10) | \$ (25) |
| | ===== | ===== |
| Net Loss As Reported | \$ (2,173) | \$ (57,836) |
| Pro Forma Compensation Expense | (46) | (553) |
| | ----- | ----- |
| Pro Forma Net Loss | \$ (2,219) | \$ (58,389) |
| | ===== | ===== |
| Basic and Diluted Loss Per Share: | | |
| As Reported | \$ (0.07) | \$ (1.88) |
| Pro Forma | (0.07) | (1.90) |

INSURANCE SERVICES

Deferred Policy Acquisition Costs

Insurance Services' deferred policy acquisition costs, consisting principally of commissions and premium taxes paid at the time of issuance of the insurance policy, are deferred and amortized over the period during which the related insurance premiums are earned. Deferred policy acquisition costs are limited to the estimated future profit, based on the anticipated losses and loss adjustment expenses ("LAE") (based on historical experience), maintenance costs, policyholder dividends, and anticipated investment income. Deferred policy acquisition costs were \$431,000 and \$833,000 at March 31, 2004 and March 28, 2003, respectively.

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Unpaid Losses and Loss Adjustment Expenses

Unpaid losses and LAE are based on estimates of reported losses and historical experience for incurred but unreported claims, including losses reported by other insurance companies for reinsurance assumed, and estimates of expenses for investigating and adjusting all incurred and unadjusted claims. Management believes that the provisions for unpaid losses and LAE are adequate to cover the cost of losses and LAE incurred to date. However, such liability is, by necessity, based upon estimates, which may change in the near term, and there can be no assurance that the ultimate liability will not exceed, or even materially exceed, such estimates. The loss and LAE is continually monitored and reviewed, and as settlements are made or reserves adjusted, differences are included in current operations.

Reinsurance

In the normal course of business, Insurance Services seeks to reduce the loss that may arise from catastrophes or other events which cause unfavorable underwriting results by reinsuring certain levels of risk in various areas of exposure with other insurance enterprises or reinsurers.

Insurance Services accounts for its reinsurance contracts which provide indemnification by reducing earned premiums for the amounts ceded to the reinsurer and establishing recoverable amounts for paid and unpaid losses and LAE ceded to the reinsurer. Amounts recoverable from reinsurers are estimated in a manner consistent with the claim liability associated with the reinsured policy. Contracts that do not result in the reasonable possibility that the reinsurer may realize a significant loss from the insurance risk generally do not meet conditions for reinsurance accounting and are accounted for as deposits. For the quarters ended March 31, 2004 and March 28, 2003, Insurance Services had no reinsurance contracts which were accounted for as deposits.

Earned Premiums

Insurance Services' earned premium income is recognized ratably over the contract period of an insurance policy. A liability is established for unearned insurance premiums that represent the portion of premium received which is applicable to the remaining portion of the unexpired terms of the related policies. Reinsurance premiums are accounted for on a basis consistent with those used in accounting for the original policies issued and the terms of the reinsurance contracts.

Insurance Services establishes an allowance for premium receivables and reinsurance recoverables through a charge to general and administrative expenses based on historical experience. After all collection efforts have been exhausted, Insurance Services reduces the allowance for balances that have been deemed uncollectible.

ENERGY AND WATER

Service Revenues

Covanta's revenues are generally earned under contractual arrangements. Service revenues include:

- o Fees earned under contract to operate and maintain waste to energy, independent power and water facilities;

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- o Fees earned to service project debt (principal and interest) where such fees are expressly included as a component of the service fee paid by the client community pursuant to applicable waste to energy service agreements.
- o Regardless of the timing of amounts paid by client communities relating to project debt principal, Covanta records service revenue with respect to this principal component on a levelized basis over the term of the service agreement. Long-term unbilled service receivables related to waste to energy operations are discounted in recognizing the present value for services performed currently in order to service the principal component of the project debt;
- o Fees earned for processing waste in excess of service agreement requirements;
- o Tipping fees earned under waste disposal agreements; and
- o Other miscellaneous fees such as revenue for scrap metal recovered and sold.

Electricity and Steam Sales

Revenue from the sale of electricity and steam are earned at energy facilities and are recorded based upon output delivered and capacity provided at rates specified under contract terms or prevailing market rates net amounts due to client communities under applicable service agreements.

Construction Revenues

Revenues under fixed-price contracts, including construction, are recognized on the basis of the estimated percentage of completion of services rendered. Anticipated losses are recognized as soon as they become known.

Property, Plant and Equipment

As of March 10, 2004, property, plant, and equipment was recorded at its estimated fair values based upon discounted cash flows using currently available information. For financial reporting purposes, depreciation is calculated by the straight-line method over the estimated remaining useful lives of the assets, which range generally from three years for computer equipment to 41 years for waste-to-energy facilities.

Service and Energy Contracts

As of March 10, 2004, service and energy contracts were recorded at their estimated fair values based upon discounted cash flows from the service contracts and the above market portion of the energy contracts using currently available information. Amortization is calculated by the straight-line method over the estimated life of the underlying agreements.

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Estimated amortization over the next five years is as follows (in thousands):

| | |
|-----------|----------|
| 2004..... | \$21,346 |
| 2005..... | 28,900 |
| 2006..... | 28,900 |
| 2007..... | 28,900 |
| 2008..... | 26,425 |

Goodwill

Goodwill represents the amount by which the purchase price for Covanta exceeds the fair value of its tangible assets and identified intangible assets less its liabilities. Pursuant to the provisions of Statement of Financial Accounting

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Standards No. 142 "Goodwill and Other Intangible Assets" ("SFAS No. 142"), goodwill is not amortized but is subject to annual impairment testing or when indicators of impairment exist.

Restricted Funds

Restricted funds held in trust are primarily amounts received by third party trustees relating to projects owned by Covanta, and which may be used only for specified purposes. Covanta generally does not control these accounts. They include debt service reserves for payment of principal and interest on project debt, deposits of revenues received with respect to projects prior to their disbursement as provided in the relevant indenture or other agreements, lease reserves for lease payments under operating leases, and proceeds received from financing the construction of energy facilities. Such funds are invested principally in United States Treasury bills and notes and United States government agencies securities.

Project Development Costs

Covanta capitalizes project development costs once it is determined that it is probable that such costs will be realized through the ultimate construction of a plant. These costs include outside professional services, permitting expense and other third party costs directly related to the development of a specific new project. Upon the start-up of plant operations or the completion of an acquisition, these costs are generally transferred to property, plant and equipment and are amortized over the estimated useful life of the related project or charged to construction costs in the case of a construction contract for a facility owned by a municipality. Capitalized project development costs are charged to expense when it is determined that the related project is impaired.

Pension and Postretirement Plans

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Covanta has pension and post-retirement obligations and costs that are developed from actuarial valuations. Inherent in these valuations are key assumptions including discount rates, expected return on plan assets and medical trend rates. Changes in these assumptions are primarily influenced by factors outside Covanta's control and can have a significant effect on the amounts reported in the financial statements.

Interest Rate Swap Agreements

The fair value of interest rate swap agreements are recorded as assets and liabilities, with changes in fair value during the year credited or charged to debt service revenue or debt service charges, as appropriate.

Long-Lived Assets

Covanta accounts for the impairment of long-lived assets to be held and used by evaluating the carrying value of its long-lived assets in relation to the operating performance and future undiscounted cash flows of the underlying businesses when indications of impairment are present. If the carrying value of such assets is greater than the anticipated future undiscounted cash flows of those assets, Covanta would measure and record the impairment amount, if any, as the difference between the carrying value of the assets and the fair value of those assets.

Foreign Currency Translation

For foreign operations, assets and liabilities are translated at year-end exchange rates and revenues and expenses are translated at the average exchange rates during the year. For subsidiaries whose functional currency is deemed to be other than the U.S. dollar, translation adjustments are included as a separate component of other comprehensive income (loss) and shareholders' equity. Currency transaction gains and losses are recorded in Other-net in the Statements of Consolidated Operations and Comprehensive Income (Loss).

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NEW ACCOUNTING PRONOUNCEMENTS

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN No. 46"). FIN No. 46 clarifies the application of Accounting Research Bulletin No. 51, "Consolidated Financial Statements," and applies immediately to any variable interest entities created after January 31, 2003 and to variable interest entities in which an interest is obtained after that date. FIN No. 46 was revised in December 2003 and is applicable for the Company on January 1, 2004 for interests acquired in variable interest entities prior to February 1, 2003. The Company adopted the provisions of FIN No. 46 without impact on its financial position or results of operations.

RECLASSIFICATION

Certain prior period amounts, including various revenues and expenses, have been reclassified in the Financial Statements to conform with the current

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period presentation.

NOTE 5. EQUITY IN INCOME AND LOSSES OF EQUITY INVESTEEES

DHC wrote off its investment in ACL during the quarter ended March 28, 2003. The GMS and Vessel Leasing investments are not considered by DHC to be impaired. The reported net income (loss) for the quarters ended March 31, 2004 and March 28, 2003, includes, under the caption "Equity in Net Income (Loss) of Unconsolidated Investments", the following components (in thousands):

| | MARCH 31, 2004 | MARCH 28, 2003 |
|---|----------------|----------------|
| | ----- | ----- |
| ACL's Reported Loss for the Three Months Ended | \$ -- | \$ (46,998) |
| Other Than Temporary Impairment of Remaining Investment in ACL as of March 28, 2003 | -- | (8,205) |
| | ----- | ----- |
| Total ACL Loss | -- | (55,203) |
| GMS Loss | (19) | (34) |
| Vessel Leasing Income | 102 | 63 |
| | ----- | ----- |
| Equity in Net Income (Loss) of Unconsolidated Marine Services Subsidiaries | 83 | (55,174) |
| Equity in Net Income of Unconsolidated Energy and Water Investments | 932 | -- |
| | ----- | ----- |
| Equity in Net Income (Loss) of Unconsolidated Investments | \$ 1,015 | \$ (55,174) |
| | ===== | ===== |

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Activity in the equity investees for the quarters ended March 31, 2004 and March 28, 2003 is as follows (in thousands):

| | MARCH 31, 2004 | | | |
|--------------------------|----------------|-----------|-------------------|----------------------|
| | ACL | GMS | VESSEL LEASING | QUEZON (THE PHILI |
| | ----- | ----- | ----- | ----- |
| Net Revenue | \$ 139,670 | \$ 13,778 | \$ 1,240 | \$ 11 |
| Operating (Loss) Income* | (8,175) | 1,111 | 758 | 5 |
| Net (Loss) Income | (23,774) | (354) | 204 | 3 |

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MARCH 28, 2003

| | ACL | GMS | VESSEL LEASING | QUEZON (THE PHILIPPINES) |
|--------------------------|------------|-----------|-------------------|-----------------------------|
| Net Revenue | \$ 139,153 | \$ 13,150 | \$ 1,152 | \$ |
| Operating (Loss) Income* | (27,791) | 618 | 680 | |
| Net (Loss) Income | (46,998) | (624) | 126 | |

*Before ACL Reorganization Expenses

NOTE 6. INVESTMENTS

DHC's fixed maturity and equity securities portfolio is classified as "available for sale" and is carried at fair value. Changes in fair value are credited or charged directly to stockholders' equity as unrealized gains or losses, respectively. "Other than temporary" declines in fair value are recorded as realized losses in the statement of operations and the cost basis of the security is reduced.

NOTE 7. PER SHARE DATA

Per share data is based on the weighted average number of shares of common stock of DHC, par value \$0.10 per share ("Common Stock"), outstanding during the relevant period. Basic earnings per share are calculated using only the average number of outstanding shares of Common Stock. Such average shares were 31,954,042 and 30,817,297 for the quarters ended March 31, 2004 and March 28, 2003, respectively. Diluted earnings per share computations, as calculated under the treasury stock method, include the average number of shares of additional outstanding Common Stock issuable for stock options, warrants, rights and convertible notes whether or not currently exercisable.

5,120,853 shares of Common stock issued on December 2, 2003 pursuant to the note purchase agreement were included in the weighted average outstanding shares calculation as of March 10, 2004, the date on which certain conditions upon which the shares were contingently returnable were satisfied. The weighted average number of such shares included in the basic and diluted earnings per share calculation was 1,238,008 for the quarter ended March 31, 2004.

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Options to purchase 182,500 shares of Common Stock at exercise prices ranging from \$7.00 to \$7.0625 per share and options to purchase 3,343,918 shares of Common Stock at exercise prices ranging from \$3.37 to \$7.0625 per share were outstanding during the quarters ended March 31, 2004, and March 31, 2003, respectively but were not included in the computation of diluted earnings per

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share because the options' exercise price was greater than the average market price of the Common Stock. 180,000 and 3,013,293 of such options were outstanding as of March 31, 2004, and March 31, 2003, respectively. Options to purchase 2,382,043 shares of Common Stock at exercise prices ranging from \$1.45 to \$6.6875 per share, rights to purchase 3,000,000 shares of Common Stock at \$1.53 per share, and \$40 million notes convertible into shares of Common Stock at a price of \$1.53 per share were outstanding during the quarter ended March 31, 2004 but were not included in the computation of diluted earnings per share because the effect would have been antidilutive. 1,949,917 of such options were outstanding as of March 31, 2004. See Note 2 for additional information regarding the rights and convertible notes.

NOTE 8. REINSURANCE

NAICC cedes reinsurance on an excess of loss basis for workers' compensation risks in excess of \$500,000 prior to April 2000 and \$200,000 thereafter. For all other lines, NAICC cedes reinsurance on an excess of loss basis for exposure in excess of \$250,000.

NOTE 9. CREDIT ARRANGEMENTS

In connection with the effectiveness of the Covanta Reorganization Plan and the consummation of the acquisition of Covanta by DHC, Covanta emerged from bankruptcy with a new debt structure. Domestic Borrowers have two credit facilities; the First Lien Facility and the Second Lien Facility.

- o The First Lien Letter of Credit Facility ("First Lien Facility") provides commitments for the issuance of letters of credit contractually required in connection with a waste-to-energy facility. These letters of credit are currently required in the aggregate amount of approximately \$138.2 million as of March 31, 2004, and the contractually required amount decreases semi-annually. The First Lien Facility has a term of five years, and requires cash collateral to be posted for issued letters of credit in the event Covanta has cash in excess of specified amounts. Covanta paid a 1% upfront fee (approximately \$1.4 million) upon entering into the First Lien Facility, and will pay with respect to each issued letter of credit (i) a fronting fee equal to the greater of \$500 or 0.25% per annum of the daily amount available to be drawn under such letter of credit, (ii) a letter of credit fee equal to 2.5% per annum of the daily amount available to be drawn under such letter of credit, and (iii) an annual fee of \$1,500.
- o The Second Lien Letter of Credit Facility ("Second Lien Facility") provides commitments in the aggregate amount of \$118 million, up to \$10.0 million of which shall also be available for cash borrowings on a revolving basis and the balance for letters of credit supporting Covanta's domestic and international businesses. This Second Lien Facility has a term of five years. The Second Lien Facility requires cash collateral to be posted for issued letters of credit in the event Covanta has cash in excess of specified amounts. The revolving loan component of the second lien credit facility bears interest at either (i) 4.5% over a base rate with reference to either the Federal Funds rate of the Federal Reserve System or Bank One's prime rate or (ii) 6.5% over a formula Eurodollar rate, the applicable rate to be determined by Covanta (increasing by 2% over the then applicable rate in specified default situations). Covanta also paid an upfront fee of \$2.36 million upon entering into the second lien credit

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agreement, and will pay (i) a commitment fee equal to 0.5% per annum of the daily calculation of available credit, (ii) an annual agency fee of \$30,000, and (iii) with respect to each issued letter of credit an amount equal to 6.5% per annum of the daily amount available to be drawn under such letter of credit. As of March 31, 2004, letters of credit in the approximate aggregate amount of \$85.9 million had been issued under the Second Lien Facility,

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which amount was reduced to \$70.9 million as of April 2, 2004, and Covanta had not sought to make draws against the \$10.0 million liquidity facility of the Second Lien Facility.

Total fees of \$11.6 million paid on March 10, 2004 have been capitalized and are being amortized using the interest method over the life of the credit facilities on a straight line basis to the extent no borrowings exist. Both facilities are secured by the assets of the Domestic Borrowers not otherwise pledged. The lien of the Second Lien Facility is junior to that of the First Lien Facility.

Also, CPIH and each of its domestic subsidiaries, which hold all of the assets and operations of Covanta's international businesses (the "CPIH Borrowers") entered into a term loan facility:

- o The CPIH Revolving Credit Facility is secured by a first priority lien on the CPIH stock and substantially all of the CPIH Borrowers' assets not otherwise pledged and consists of commitments for cash borrowings of up to \$10 million for purposes of supporting the international businesses. The CPIH revolving credit facility has a maturity date of three years and to the extent drawn upon bears interest at the rate of either (i) 7% over a base rate with reference to either the Federal Funds rate of the Federal Reserve System or Deutsche Bank's prime rate or (ii) 8% over a formula Eurodollar rate, the applicable rate to be determined by CPIH (increasing by 2% over the then applicable rate in specified default situations). CPIH also paid a 2% upfront fee of \$200,000, and will pay (i) a commitment fee equal to 0.5% per annum of the average daily calculation of available credit, and (ii) an annual agency fee of \$30,000. As of March 31, 2004, CPIH had not sought to make draws on this facility.

The debt of the CPIH Borrowers is non-recourse to Covanta and its other domestic subsidiaries.

NOTE 10. OTHER LONG-TERM DEBT

Long-term debt consisted of the following at March 31, 2004 (in thousands):

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| | | |
|--|----|---------|
| High yield notes | \$ | 205,190 |
| CPIH term loan facility | | 94,825 |
| Unsecured notes | | 36,500 |
| Other long-term debt | | 10,891 |
| | | ----- |
| Total | | 347,406 |
| Less current portion of long term debt | | (9,631) |
| | | ----- |
| Total | \$ | 337,775 |
| | | ===== |

The Domestic Borrowers also issued two additional series of notes pursuant to indentures, which are referred to herein as the "High Yield Notes" and "Unsecured Notes".

- o The High Yield Notes are secured by a third priority lien in the same collateral securing the First Lien Facility and the Second Lien Facility. The High Yield Notes were issued in the initial principal amount of \$205.0 million, which will accrete to \$230.0 million at maturity in seven years. Interest is payable at a rate of 8.25% semi-annually on the basis of the principal at final maturity; no principal is due prior to maturity of the High Yield Notes; and the High Yield Notes may be prepaid without premium or penalty within two years of issuance.
- o Unsecured Notes in a principal amount of \$4.0 million were issued on the effective date of the Covanta Reorganization Plan, and Covanta expects to issue additional Unsecured Notes in a principal amount of between \$30.0 million and \$35.0 million including additional Unsecured Notes that may be issued to holders

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of allowed claims against the remaining debtors if and when they emerge from bankruptcy. The final principal amount of all Unsecured Notes will be equal to the amount of allowed unsecured claims against Covanta's operating subsidiaries which were reorganizing debtors, and such amount will be determined when such claims are resolved through settlement or further proceedings in the Bankruptcy Court. The principal amount of Unsecured Notes indicated in the table above represents the expected liability upon completion of the claims process. Notwithstanding the date on which Unsecured Notes are issued, interest on the Unsecured Notes accrues from March 10, 2004. Interest is payable semi-annually on the Unsecured Notes at a rate of 7.5%; principal is paid annually beginning in March, 2006. The Unsecured Notes mature in eight years.

Also, CPIH Borrowers entered into the following term loan facility:

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- o The CPIH Term Loan Facility of up to \$95 million secured by a second priority lien on the same collateral as the CPIH Revolving Credit Facility, and bears interest at 10.5% per annum, 6.0% of such interest to be paid in cash and the remaining 4.5% to be paid in cash to the extent available and otherwise payable by adding it to the outstanding principal balance. The interest rate increases to 12.5% per annum in specified default situations. The CPIH Term Loan Facility matures in three years.

The debt of the CPIH Borrowers is non-recourse to Covanta and its other domestic subsidiaries.

Covanta may issue tax notes in an aggregate principal amount equal to the aggregate amount of allowed priority tax claims with a maturity six years after the date of assessment. Interest will be payable semi-annually at the rate of four percent. Under the Covanta Reorganization Plan, Covanta may pay the amount of such claims in cash.

The maturities on long-term debt including capital lease obligations at March 31, 2004 were as follows (in thousands):

| | |
|----------------------|------------|
| 2004 | \$ 9,631 |
| 2005 | 25 |
| 2006 | 1,235 |
| 2007 | 94,825 |
| Later years | 241,690 |
| | ----- |
| Total | 347,406 |
| Less current portion | (9,631) |
| | ----- |
| Total long-term debt | \$ 337,775 |
| | ===== |

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NOTE 11. PROJECT DEBT

Project debt consisted of the following at March 31, 2004 (in thousands):

| | |
|---|---------|
| Revenue Bonds Issued by and Prime Responsibility of Municipalities: | |
| 3.625-6.75% serial revenue bonds due 2005 through 2011 | \$ 306, |
| 5.0-7.0% term revenue bonds due 2005 through 2015 | 165, |
| Adjustable-rate revenue bonds due 2006 through 2013 | 120, |
| | ----- |

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| | |
|---|---------|
| Sub total | 593, |
| ----- | |
| Revenue Bonds Issued by Municipal Agencies with Sufficient Service Revenues Guaranteed by Third Parties: | |
| 5.25-8.9% serial revenue bonds due 2005 through 2008 | 24, |
| ----- | |
| Other Revenue Bonds: | |
| 4.7-5.5% serial revenue bonds due 2005 through 2015 | 72, |
| 5.5-6.7% term revenue bonds due 2014 through 2019 | 69, |
| ----- | |
| Sub total | 142, |
| ----- | |
| Other project debt | 87, |
| ----- | |
| Total long-term project debt | 847, |
| Current portion of project debt | 94, |
| ----- | |
| Total | \$ 941, |
| ===== | |

Project debt associated with the financing of waste-to-energy facilities is generally arranged by municipalities through the issuance of tax-exempt and taxable revenue bonds. The category, "Revenue Bonds Issued by and Prime Responsibility of Municipalities," includes bonds issued with respect to projects owned by Covanta for which debt service is an explicit component of the client community's obligation under the related service agreement. In the event that a municipality is unable to satisfy its payment obligations, the bondholders' recourse with respect to Covanta is limited to the waste-to-energy facilities and restricted funds pledged to secure such obligations.

The category "Revenue Bonds Issued by Municipal Agencies with Sufficient Service Revenues Guaranteed by Third Parties" includes municipal bonds issued to finance two facilities for which contractual obligations of third parties to deliver waste ensure sufficient revenues to pay debt service, although such debt service is not an explicit component of the third parties' service fee obligations.

The category "Other Revenue Bonds" includes bonds issued to finance one facility for which current contractual obligations of third parties to deliver waste provide sufficient revenues to pay debt service related to that facility through 2011, although such debt service is not an explicit component of the third parties' service fee obligations. Covanta anticipates renewing such contracts prior to 2011.

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Payment obligations for the project debt associated with facilities owned by Covanta are limited recourse to the operating subsidiary and non-recourse to Covanta, subject to construction and operating performance guarantees and commitments. These obligations are secured by the revenues pledged under various indentures and are collateralized principally by a mortgage lien and a security interest in each of the respective facilities and related assets.

The maturities on long-term project debt at March 31, 2004 were as follows (in thousands):

| | | |
|------------------------------|----|----------|
| 2004 | \$ | 64,525 |
| 2005 | | 93,696 |
| 2006 | | 99,904 |
| 2007 | | 98,183 |
| 2008 | | 98,048 |
| Later years | | 486,781 |
| | | ----- |
| Total | | 941,137 |
| Less current portion | | (94,134) |
| | | ----- |
| Total long-term project debt | \$ | 847,003 |
| | | ===== |

NOTE 12. INCOME TAXES

DHC files a Federal consolidated income tax return with its subsidiaries. DHC's Federal consolidated return includes the taxable results of certain grantor trusts established pursuant to a prior court approved reorganization to assume various liabilities of certain present and former subsidiaries of DHC. These trusts are not consolidated with DHC for financial statement purposes. DHC's Federal consolidated return will exclude the results of CPIH since their operations do not qualify for consolidation under the applicable tax laws. DHC records its interim tax provisions based upon estimated effective tax rates for the year.

DHC's provision for income taxes in the condensed consolidated statements of operations consists of certain state and other taxes. Tax filings for these jurisdictions do not consolidate the activity of the trusts referred to above, and reflect preparation on a separate company basis. For further information, reference is made to Note 13 of the Notes to the Consolidated Financial Statements included in DHC's Annual Report on Form 10-K for the year ended December 31, 2003.

DHC had NOLs estimated to be approximately \$652 million for Federal income tax purposes as of the end of 2003. The NOLs will expire in various amounts beginning on December 31, 2004 through December 31, 2023, if not used. In connection with the purchase of Covanta, the Company reassessed its valuation allowances on deferred tax benefits associated with its NOLs. Included in the consolidated financial statements is a deferred tax asset of \$91.7 million associated with the reduction in valuation allowances to reflect the estimated future NOL utilization from the inclusion of Covanta (exclusive of its international holding company) in DHC's consolidated Federal income tax group. The Internal Revenue Service ("IRS") has not audited any of DHC's tax returns. There can be no assurance that DHC would prevail if the IRS were to challenge

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the use of the NOLs.

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If DHC were to undergo, an "ownership change" as such term is used in Section 382 of the Internal Revenue Code, the use of its NOLs would be limited. DHC will be treated as having had an "ownership change" if there is a more than 50% increase in stock ownership during a 3-year "testing period" by "5% stockholders". DHC's Certificate of Incorporation contains stock transfer restrictions that were designed to help preserve DHC's NOLs by avoiding an ownership change. The transfer restrictions were implemented in 1990, and DHC expects that they will remain in-force as long as DHC has NOLs. DHC cannot be certain, however, that these restrictions will prevent an ownership change.

NOTE 13. STOCKHOLDERS' EQUITY

As of March 31, 2004, there were 35,969,941 shares of Common Stock issued of which 35,959,145 were outstanding; the remaining 10,796 shares of Common Stock issued but not outstanding are held as treasury stock. In connection with efforts to preserve DHC's NOLs, DHC has imposed restrictions on the ability of holders of five percent or more of Common Stock to transfer the Common Stock owned by them and to acquire additional Common Stock, as well as the ability of others to become five percent stockholders as a result of transfers of Common Stock.

The following represents shares of Common Stock reserved for future issuance as of March 31, 2004:

| | |
|---|----------------|
| 2004 rights offering | 26,969,359 (A) |
| Required conversion of Laminar debt | 8,750,000 (A) |
| Stock purchase rights of certain creditors of Covanta | 3,000,000 (A) |
| Stock options exercisable in 2004 | 1,687,414 |
| | 40,406,773 |
| | 40,406,773 |

(A) The number of shares is based on the maximum number of shares which could be issued assuming 100% stockholder participation in the rights offering. The number of shares for the required conversion of Laminar debt and the stock purchase rights of certain creditors of Covanta are subject to the level of public participation in the rights offering (as defined in the agreements), as well as other limitations regarding the Covanta creditors' stock purchase rights.

NOTE 14. BUSINESS SEGMENTS

DHC has four reportable business segments - energy and water,

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insurance, marine and corporate. Energy and Water develops, constructs, owns and operates for others key infrastructure for the conversion of waste to energy, independent power production and the treatment of water and waste water in the United States and abroad. The Insurance Services segment writes property and casualty insurance in the western United States, primarily in California. The Marine segment includes the barging, construction and terminals segments of the Marine Services businesses which are accounted for using the equity method beginning in 2003. The corporate segment represents the operating expenses and miscellaneous income of the holding company, DHC.

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Management evaluates performance based on segment earnings, which is defined as operating income before income taxes. The accounting policies of the reportable segments are consistent with those described in the summary of significant accounting policies.

| | (IN THOUSANDS) | |
|---|---------------------------------|---------------------------------|
| | QUARTER ENDED MARCH 31, 2004 | QUARTER ENDED MARCH 28, 2003 |
| | ----- | ----- |
| Revenues: | | |
| Energy and Water | | |
| Domestic Energy and Water | \$ 29,798 | \$ -- |
| International Energy | 9,178 | -- |
| | ----- | ----- |
| Subtotal Energy and Water | 38,976 | -- |
| Insurance | 6,899 | 11,076 |
| Corporate | -- | -- |
| | ----- | ----- |
| Total Revenues | 45,875 | 11,076 |
| | ----- | ----- |
| Income (Loss) from Operations: | | |
| Energy and Water | | |
| Domestic Energy and Water | 4,736 | -- |
| International Energy | 2,499 | -- |
| Unallocated Income and (Expenses) - Net | (2,723) | -- |
| | ----- | ----- |
| Subtotal Energy and Water | 4,512 | -- |
| Insurance | 104 | (1,783) |
| Corporate | (693) | (867) |
| | ----- | ----- |
| Income (Loss) from Operations | 3,923 | (2,650) |
| | ----- | ----- |
| Other | | |

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| | | |
|---|------------|-------------|
| Interest Expense - Net | (6,922) | -- |
| Equity in Net Income (Loss) of Unconsolidated Investments | 1,015 | (55,174) |
| | ----- | ----- |
| Loss before Minority Interests and Provision for Income Taxes | \$ (1,984) | \$ (57,824) |
| | ===== | ===== |

As previously described in Note 5, the investment in ACL was written off during the quarter ended March 28, 2003.

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The following is a reconciliation of segment loss to consolidated pre-tax totals:

| | (IN THOUSANDS) | |
|---|---------------------------------|--------------------|
| | QUARTER ENDED MARCH 31, 2004 | QUARTER MARCH 2 |
| | ----- | ----- |
| Total Segment Income (Loss) | \$ 3,923 | \$ |
| Unallocated Amounts: | | |
| Interest Expense | (6,922) | |
| Equity in Net Income (Loss) of Unconsolidated Investments | 1,015 | |
| | ----- | ----- |
| Loss before Minority Interests and Provision for Income Taxes | \$ (1,984) | \$ |
| | ===== | ===== |

NOTE 15. EMPLOYEE BENEFIT PLANS

Net periodic benefit cost for the Company's pension and other post-retirement benefit plans is immaterial for each of the quarters presented.

NOTE 16. INTEREST EXPENSE

Interest expense in the condensed consolidated statement of operations for the quarter ended March 31, 2004 is comprised of the following (in thousands):

| | |
|-----------------------|----------|
| Parent Company Debt | \$ 4,273 |
| Energy and Water Debt | 2,649 |
| | ----- |
| | \$ 6,922 |

=====

Parent Company Debt interest expense is comprised of the amortization of deferred financing costs of \$3,073 and accrued interest payable on the Covanta bridge financing of \$1,200.

NOTE 17. COMMITMENTS AND CONTINGENT LIABILITIES

At March 31, 2004, capital commitments for operations amounted to \$11.2 million for normal maintenance and replacement in domestic energy and water. Other capital commitments for domestic energy and water and international energy as of March 31, 2004 amounted to approximately \$11.9 million. This amount includes a commitment to pay \$10.6 million in 2009 for a service contract extension at an energy facility. In addition, this amount includes a commitment to contribute \$1.3 million in capital to an investment in a waste-to-energy facility in Italy which is expected to be contributed in late 2004.

Covanta and certain of its subsidiaries have issued or are party to performance bonds and guarantees and related contractual obligations undertaken mainly pursuant to agreements to construct and operate certain energy facilities.

The surety bonds relate to performance under its waste water treatment operating contracts (\$8.5 million), possible closure costs for various energy projects when such projects cease operating (\$10.8 million) and to energy businesses that have been sold and the related surety bonds (\$1.2 million) are expected to be cancelled in 2004.

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The Company is party to a number of other claims, lawsuits and pending actions, most of which are routine and all of which are incidental to its business. Covanta assesses the likelihood of potential losses on an ongoing basis and when losses are considered probable and reasonably estimable, records as a loss an estimate of the ultimate outcome. If Covanta can only estimate the range of a possible loss, an amount representing the low end of the range of possible outcomes is recorded. The final consequences of these proceedings are not presently determinable with certainty.

Generally claims and lawsuits against the Covanta debtors emerging from bankruptcy upon consummation of DHC's acquisition of Covanta arising from events occurring prior to their respective petition date have been resolved pursuant to the Covanta Reorganization Plan, and have been discharged pursuant to the March 5, 2004 order of the Bankruptcy Court which confirmed the Covanta Reorganization Plan. However, to the extent that claims are not dischargeable in bankruptcy, such claims may not be discharged. For example, the claims of certain persons who were personally injured prior to the petition date but whose injury only became manifest thereafter may not be discharged pursuant to the Covanta Reorganization Plan.

ENVIRONMENTAL MATTERS

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Covanta's operations are subject to the environmental regulatory laws and the environmental remediation laws. Although Covanta's operations are occasionally subject to proceedings and orders pertaining to emissions into the environment and other environmental violations, which may result in fines, penalties, damages or other sanctions, Covanta believes that it is in substantial compliance with existing environmental laws and regulations.

Covanta may be identified, along with other entities, as being among parties potentially responsible for contribution to costs associated with the correction and remediation of environmental conditions at disposal sites subject to CERCLA and/or analogous state laws. In certain instances, Covanta may be exposed to joint and several liability for remedial action or damages. Covanta's ultimate liability in connection with such environmental claims will depend on many factors, including its volumetric share of waste, the total cost of remediation, the financial viability of other companies that also sent waste to a given site and, in the case of divested operations, its contractual arrangement with the purchaser of such operations. Generally such claims arising prior to the petition date were resolved in and discharged by the Chapter 11 Cases.

On September 15, 2003, the Environmental Protection Agency (the "EPA") issued a "General Notice Letter" identifying Covanta as among 41 potentially responsible parties ("PRPs") with respect to the Diamond Alkali Superfund Site/"Lower Passaic River Project." The EPA alleges that the PRPs are liable for releases or potential releases of hazardous substances to a 17 mile segment of the Passaic River, located in northern New Jersey, and requests the PRPs' participation as "cooperating parties" with respect to the funding of a five to seven year study to determine an environmental remedial and restoration program. Covanta has informed the EPA that it was a Debtor, the EPA did not file a proof of claim, and Covanta believes that its liability, if any, was discharged under the Covanta Reorganization Plan. On March 5, 2004, one PRP did file a motion in the Bankruptcy Court for leave to file a late proof of claim, but subsequently withdrew that motion. No other proofs of claim have been filed relating to this matter. The allegations as to Covanta relate to discontinued, non-energy operations.

In 1985, Covanta sold its interests in several manufacturing subsidiaries, some of which allegedly used asbestos in their manufacturing processes, and one of which was Avondale Shipyards, now a subsidiary of Northrop Grumman Corporation. Some of these former subsidiaries have been and continue to be parties to asbestos-related litigation. In 2001, Covanta was named a party, with 45 other defendants, to one such case. Before the first petition date, Covanta had filed for its dismissal from the case. Also, eleven proofs of claim seeking unliquidated amounts have been filed against Covanta in the Chapter 11 cases based on what appears to be purported asbestos-related injuries that may relate to the operations of former Covanta subsidiaries. Covanta believes that these claims lack merit and has filed objections to them, and plans to object vigorously to such claims if necessary to resolve them.

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The potential costs related to the following matters and the possible

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impact on future operations are uncertain due in part to the complexity of governmental laws and regulations and their interpretations, the varying costs and effectiveness of cleanup technologies, the uncertain level of insurance or other types of recovery and the questionable level of Covanta's responsibility. Although the ultimate outcome and expense of any litigation, including environmental remediation, is uncertain, Covanta believes that the following proceedings will not have a material adverse effect on Covanta's consolidated financial position or results of operations.

- o On June 8, 2001, the EPA named Covanta's wholly-owned subsidiary, Ogden Martin Systems of Haverhill, Inc., now known as Covanta Haverhill, Inc., as one of 2,000 PRPs at the Beede Waste Oil Superfund Site, Plaistow, New Hampshire in connection with alleged waste disposal by PRPs on this site. On January 9, 2004, the EPA signed its Record of Decision with respect to the cleanup of the site. According to the EPA, the costs of response actions incurred as of January 2004 by the EPA and the State of New Hampshire total approximately \$19 million, and the estimated cost to implement the remedial alternative selected in the Record of Decision is an additional \$48 million. Covanta Haverhill, Inc. is participating in PRP group discussions towards settlement of the EPA's claims and will continue to seek a negotiated resolution of this matter. Although Covanta Haverhill, Inc.'s share of liability, if any, cannot be determined at this time as a result of uncertainties regarding the source and scope of contamination, the large number of PRPs and the varying degrees of responsibility among various classes of PRPs, Covanta believes that based on the amount of materials Covanta Haverhill, Inc. sent to the site, any liability will not be material. Covanta Haverhill, Inc. was not in the Covanta Bankruptcy.
- o On May 25, 2000 the California Regional Water Quality Control Board, Central Valley Region, issued a cleanup and abatement order to Pacific-Ultrapower Chinese Station ("Chinese Station"), a general partnership in which one of Covanta's subsidiaries owns 50% and which owns and operates an independent power project in Jamestown, California which uses waste wood as a fuel. The order is in connection with the partnership's neighboring property owner's use of ash generated by Chinese Station's plant. Chinese Station completed the cleanup in mid-2001 and submitted its Clean Closure Report to the Water Quality Control Board on November 2, 2001. The Board and other state agencies continue to investigate alleged civil and criminal violations associated with the management of the material. The partnership believes it has valid defenses, and a petition for review of the order is pending. Settlement discussions in this matter are underway. Based on penalties proposed by the Board, Covanta believes that this matter can be resolved in amounts that will not be material to Covanta taken as a whole. Chinese Station and Covanta's subsidiary that owns a partnership interest in Chinese station were not debtors in the Covanta bankruptcy.

OTHER MATTERS

- o In late 2000, Lake County, Florida commenced a lawsuit in Florida state court against Covanta Lake, Inc. (now merged with Covanta Lake II, Inc., ("Covanta Lake")) which also refers to its merged successor, as defined below) relating to the waste-to-energy facility operated by Covanta in Lake

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County, Florida (the "Lake Facility"). In the lawsuit, Lake County sought to have its service agreement with Covanta Lake (the "Lake Service Agreement") declared void and in violation of the Florida Constitution. That lawsuit was stayed by the commencement of the Chapter 11 Cases. Lake County subsequently filed a proof of claim seeking in excess of \$70 million from Covanta Lake and Covanta.

On June, 20, 2003, Covanta Lake filed a motion with the Bankruptcy Court seeking entry of an order (i) authorizing Covanta Lake to assume, effective upon confirmation of a plan of reorganization for Covanta Lake, the Lake Service Agreement with Lake County, (ii) finding no cure amounts due under the Service Agreement, and (iii) seeking a declaration that the Lake Service Agreement is valid, enforceable and constitutional, and remains in full force and effect. Contemporaneously with the filing of the assumption motion, Covanta Lake filed an adversary complaint asserting that Lake County is in arrears to

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Covanta Lake in the amount of more than \$8.5 million. Shortly before trial commenced in these matters, Covanta and Lake County reached a tentative settlement calling for a new agreement specifying the parties' obligations and restructuring of the project. That tentative settlement and the proposed restructuring will involve, among other things, termination of the existing Lake Service Agreement and the execution of a new waste disposal agreement which shall provide for a put-or-pay obligation on Lake County's part to deliver 163,000 tons per year of acceptable waste to the Lake Facility and a different fee structure; a replacement guarantee from Covanta in a reduced amount; the payment by Lake County of all amounts due as "pass through" costs with respect to Covanta Lake's payment of property taxes; the payment by Lake County of a specified amount in each of 2004, 2005 and 2006 in reimbursement of certain capital costs; the settlement of all pending litigation; and a refinancing of the existing bonds.

The Lake settlement is contingent upon, among other things, receipt of all necessary approvals, as well as a favorable outcome to Covanta's pending objection to the proof of claims filed by F. Browne Gregg, a third-party claiming an interest in the existing Lake Service Agreement that would be terminated under the proposed settlement. On November 3, 2003 through November 5, 2003, the Bankruptcy Court conducted a trial on Mr. Gregg's proofs of claim. At issue in the trial was whether Mr. Gregg is entitled to damages as a result of Covanta Lake's proposed termination of the existing Lake Service Agreement and entry into a waste disposal agreement with Lake County. As of May 1, 2004, the Bankruptcy Court had

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not ruled on Covanta's claims objections. Based on the foregoing, Covanta determined not to propose a plan of reorganization or plan of liquidation for Covanta Lake, and instead that Covanta Lake should remain a debtor-in-possession after the effective date of the Covanta Reorganization Plan.

To emerge from bankruptcy without uncertainty concerning potential claims against Covanta related to the Lake Facility, Covanta has rejected its guarantees of Covanta's obligations relating to the operation and maintenance of the Lake Facility. Covanta anticipates that if a restructuring is consummated, Covanta may at that time issue new parent guarantees in connection with that restructuring and emergence from bankruptcy.

Depending upon the ultimate resolution of these matters with Mr. Gregg and Lake County, Covanta Lake may determine to assume or reject one or more executory contracts related to the Lake Facility, terminate the Service Agreement with Lake County for its breaches and default and pursue litigation against Lake County and/or Mr. Gregg. Based on this determination, Covanta may reorganize or liquidate Covanta Lake. Depending on how Covanta Lake determines to proceed, creditors of Covanta Lake may receive little or no recovery on account of their claims.

- o During 2003 Covanta Tampa Construction, Inc. ("CTC") completed construction of a 25 million gallon per day desalination-to-drinking water facility under a contract with Tampa Bay Water ("TBW") near Tampa, Florida. Covanta Energy Group, Inc., guaranteed CTC's performance under its construction contract with TBW. A separate subsidiary, Covanta Tampa Bay, Inc. ("CTB") entered into a contract with TBW to operate the Tampa Water Facility after construction and testing is completed by CTC.

As construction of the Tampa Water Facility neared completion, the parties had material disputes between them, primarily relating to (i) whether CTC has satisfied acceptance criteria for the Tampa Water Facility; (ii) whether TBW has obtained certain permits necessary for CTC to complete start-up and testing, and for CTB to subsequently operate the Tampa Water Facility; (iii) whether influent water provided by TBW for the Tampa Water Facility is of sufficient quality to permit CTC to complete start-up and testing, or to permit CTB to operate the Tampa Water Facility as contemplated and (iv) if and to the extent that the Tampa Water Facility cannot be optimally operated, whether such shortcomings constitute defaults under CTC's agreements with TBW.

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In October 2003, TBW issued a default notice to CTC, indicated

that it intended to commence arbitration proceedings against CTC, and further indicated that it intended to terminate CTC's construction agreement. As a result, on October 29, 2003, CTC filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code in order to, among other things, prevent attempts by TBW to terminate the construction agreement between CTC and TBW. On November 14, 2003, TBW commenced an adversary proceeding against CTC and filed a motion seeking a temporary restraining order and preliminary injunction directing that possession of the Tampa Water Facility be turned over to TBW. On November 25, 2003, the Bankruptcy Court denied the motion for a temporary restraining order and preliminary injunction and ordered, among other things, that the parties attempt to resolve their disputes in a non-binding mediation.

In February 2004 Covanta and TBW reached a tentative compromise of their disputes which has been approved by the Bankruptcy Court, subject to definitive documentation, and confirmation of an acceptable plan of reorganization for CTC and CTB, which were not included in the Covanta Reorganization Plan. Under that tentative compromise, all contractual relationships between Covanta and TBW will be terminated, CTC will operate the facility in "hot stand-by" for a limited period of time, and the responsibility for optimization and operation of the Tampa Water Facility will be transitioned to a new, non-affiliated operator. In addition, TBW will pay \$4.95 million to or for the benefit of CTC, of which up to \$550,000 is earmarked for the payment of claims under the subcontracts previously assigned by Covanta to TBW. The settlement funds ultimately would be distributed to creditors and equity holders of CTC and CTB pursuant to a plan of reorganization for CTC. As a result of the foregoing, Covanta determined not to include CTC and CTB in the Covanta Reorganization Plan or liquidation plan, and instead that CTC and CTB should remain debtor-in-possession after the effective date of the Covanta Reorganization Plan, and that separate plans of reorganization subsequently would be proposed for CTC and CTB. In April, 2004, CTC and CTB filed a plan of reorganization as contemplated by the settlement. It is anticipated that the Bankruptcy Court will schedule a hearing in July, 2004 at which the Court will consider confirmation of such plan of reorganization.

If the parties are unable to resolve their differences consensually, and depending upon, among other things, whether the parties are able to successfully effect the settlement described above, Covanta may, among other things, commence additional litigation against TBW, attempt to assume or reject one or more executory contracts related to the Tampa Water Facility, or propose different liquidating plans and/or plans of reorganization for CTB and/or CTC. In such an event, creditors of CTC and CTB may receive little or no recovery on account of their claims.

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(a) List of Exhibits filed with this Form 10-Q/A

Exhibit 31.1 - Certification Pursuant to Section 302 of Sarbanes-Oxley Act of 2002 from Chief Executive Officer

Exhibit 31.2 - Certification Pursuant to Section 302 of Sarbanes-Oxley Act of 2002 from Chief Financial Officer

Exhibit 32.1 - Certification of Periodic Financial Report Pursuant to Section 906 of Sarbanes-Oxley Act of 2002 from Chief Executive Officer

Exhibit 32.2 - Certification of Periodic Financial Report Pursuant to Section 906 of Sarbanes-Oxley Act of 2002 from Chief Financial Officer

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, Danielson Holding Corporation has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

DANIELSON HOLDING CORPORATION
(Danielson Holding Corporation)

By: /s/ PHILIP G. TINKLER

Philip G. Tinkler
Chief Financial Officer
May 18, 2004

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