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PRESENTATION

Operator

Good morning, and welcome to the Enviri Corporation Third Quarter 2023 Earnings Conference Call. (Operator Instructions) Please note this event is being recorded. I would now like to turn the conference over to Dave Martin for the rest of the conference. Please go ahead.

David Scott Martin ***Enviri Corporation - Director of IR***

Thank you, Debbie, and welcome to everyone joining us. I'm Dave Martin of Enviri. With me today is Nick Grasberger, our Chairman and Chief Executive Officer; and Tom Vadaketh, our Senior Vice President and Chief Financial Officer.

This morning, we will discuss our results for the third quarter of 2023 and our updated outlook. Before our presentation, however, let me mention a few things. First, our earnings release and slide presentation for this call are available on our website. Second, we will make statements today that are considered forward-looking within the meaning of the federal securities laws. These statements are based on our current knowledge and expectations and are subject to certain risks and uncertainties that may cause actual results to differ materially from those forward-looking statements. For a discussion of such risks and uncertainties, see the Risk Factors section in our most recent 10-K. The company undertakes no obligation to revise or update any forward-looking statement.

Lastly, on this call, we will refer to adjusted financial results that are considered non-GAAP for SEC reporting purposes. A reconciliation to GAAP results is included in our earnings release as well as the slide presentation. With that being said, I'll turn the call to Nick. Thank you.

F. Nicholas Grasberger ***Enviri Corporation - Chairman, President & CEO***

Thank you, Dave, and good morning, everyone. I want to welcome Tom to Enviri. Tom is a seasoned executive who has worked in both public and private companies and has had considerable success. He fits very well into our culture and I look forward to working with him as we continue our transformation. So Tom, welcome.

Once again, I would like to thank Pete Minan for his dedication to our company and to its shareholders. Pete's contributions across the company over the past 9 years are countless, and we wish him well in his retirement.

This past quarter was our fifth consecutive quarter of double-digit EBITDA growth against the prior year quarter. And once again, we exceeded expectations. As a result, we are also raising our outlook for the full year, and our focus remains squarely on boosting cash flow, reducing our leverage and completing the next step in our transformation.

Cash flow from our 2 continuing segments, Harsco Environmental and Clean Earth will improve by over $100 million this year, and we expect further growth over the next few years. Our challenge has been the cash flow in our Rail segment and much higher interest expense due primarily to higher short-term rates. Nonetheless, our leverage will decline by about 1 turn this year and we expect leverage to decline by at least another half turn next year before accounting for the impact of the Rail divestiture.

The largest contributor to our deleveraging has been the margin expansion and cash flow generation at Clean Earth. Clean Earth's EBITDA margin improved to 14% this past quarter, up 150 basis points from a strong third quarter last year, driven by pricing gains, volume growth, favorable mix and numerous projects aimed at improving operational effectiveness. Cash flow will approximate $100 million in Clean Earth this year or 11% of revenue and over 80% of EBITDA. These metrics reflect the fact that our assets require relatively modest maintenance capital, and we've been able to pass on the inflation we have incurred in disposal and other costs.

We are soon to complete our third full year of the Clean Earth segment that was created by the acquisitions and combination of 2 businesses. EBITDA has grown from about $80 million at the time of acquisition to over $120 million this year. This growth in our financial focus have driven Clean Earth's strong free cash flow, which is earning us a respectable return on our investment.

When considering the recent multiples paid for acquisitions in our industry and the outlook for our business, we are confident that this segment has created and will continue to create tremendous shareholder value. Our efforts to build a much better business from a unique set of assets include installing a new leadership team, improved pricing discipline, optimizing logistics, reducing SG&A and several other operational improvement programs. The implementation of a common IT operating platform next year will be another critical milestone to unlocking the value in the business.

Harsco Environmental continues to perform well despite weaker-than-expected steel production by our customers. Similar to Clean Earth, cash flow will be considerably higher in HE this year due to higher cash earnings and much improved working capital performance. The business has been successful in expanding the scope of current contracts with less capital-intensive services, and the eco-products business is outperforming expectations.

The operating leverage in HE is quite high, and we look forward to the impact of steel production volumes returning to at least normalized levels over the next few years.

Turning to our Rail segment. We expect to announce a sale transaction late this year or early next year as due diligence is completed. Strong anticipated financial performance by Rail in the fourth quarter will support the process and we continue to work to derisk specific long-term contracts with European customers.

Next, we released our annual ESG report a few weeks ago. The report is critical to Enviri because our mission is to create and deliver environmental solutions. And the report highlights how we measure ourselves and our progress against those metrics.

In 2022, we saw a record level of safety performance from Harsco Environmental and for the company, a 20% improvement in safety compared to the prior year. In total, we recycled or able to repurpose 35 billion pounds of waste last year. Clean Earth recycled 90% of the waste taken in and Harsco Environmental recycled or reused 87% of the slag it processed. I encourage you to review our report at enviri.com.

Looking ahead to 2024, we are optimistic. As noted, we expect to complete the sale of Rail in coming months. And while we won't provide formal 2024 financial guidance until February, it's safe to say that we are targeting continued margin and profit growth in each of our business next year. I'll now turn the call over to Tom.

Thomas G. Vadaketh ***Enviri Corporation - Senior VP & CFO***

Thanks, Nick, and good morning, everyone. Let me start by saying I'm thrilled to be part of the Enviri team. I'm excited by the company's mission and purpose and I'm looking forward to helping Enviri complete its transformation into a pure-play environmental solutions company. I've enjoyed getting to know and working with the team over the past few weeks, I have a lot to learn about the business, and I'm looking forward to getting up to speed.

Enviri's strategy is well defined and its value creation opportunities are unchanged. Reducing leverage and strengthening free cash flow generation remains paramount and our key priorities for me as CFO. I love the operational side, too, and look forward to working with our businesses to boost margins and drive growth.

Now let me turn to our results for the quarter and our outlook for Q4. Please turn to Slide 4. Enviri's third quarter revenues from continuing operations increased to $525 million, up 8% compared with the prior year quarter. The increase was driven by both pricing and volume growth in Clean Earth and Harsco Environmental. Adjusted EBITDA totaled $79 million. This result represents a 12% improvement from the prior year and is above our prior guidance range.

The stronger-than-anticipated results were driven mostly by volumes and business mix as well as strong operating cost performance in Clean Earth. Lower corporate spending also helped. Relative to the prior year quarter, each of our operating segments contributed to the growth, which I'll discuss in the next couple of slides.

Adjusted earnings per share was $0.05 for the quarter. Special items in the quarter totaled $0.08 and largely consisted of a receivables provision for an HE contract in Oman, where our customer halted production and the mill is reportedly for sale. Free cash flow for the quarter was $10 million. Excluding the A/R securitization benefit in the prior year quarter, the increase in free cash flow year-on-year was $66 million. This improvement was driven by working capital as well as lower capital spending and higher cash earnings.

As Nick alluded to, year-to-date, our continuing businesses, HE and Clean Earth have together generated free cash flow of $125 million, a significant improvement from the $16 million generated over the same period last year, driven by earnings growth and cash from working capital. This improvement in the business was partially offset by an increase in interest payments of nearly $25 million and other smaller items, resulting in underlying free cash flow improving by over $70 million for the total company during the same period last year.

Lastly, our net leverage decreased to 4.5x at quarter end and should continue to trend towards 4x at year-end. Please turn to Slide 5 and our environmental segments.

Segment revenues totaled $286 million, up 8% compared with the prior year quarter. Adjusted EBITDA reached $54 million for the quarter. Relative to the prior year quarter, HE benefited from higher eco-products and service volumes, including from new sites as well as higher pricing and cost improvement initiatives. These positives were partially offset by higher SG&A due mainly to increased incentive compensation.

HE's EBITDA margin approached 19% in the quarter. Overall, HE results are quite positive in our view, particularly given that steel production at our customer locations were modestly lower against the prior year quarter, and mill utilization rates remain low. In total, other services performed, operational improvements and price are offsetting these headwinds.

Next, please turn to Slide 6 to discuss Clean Earth. For the quarter, revenues totaled $239 million, and adjusted EBITDA was $34 million. Compared to the second quarter of 2022, revenues increased 7%. Price contributed just over 1/2 of this change with underlying volume growth led by industrial and health care markets.

Hazardous Materials revenues reached $195 million, while soil-dredge revenues totaled $44 million for the quarter. These figures represent increases of 7% and 10%, respectively. Our quarterly revenues in soil-dredge were the highest since the first quarter of 2020, reflecting the benefits of infrastructure spending, major construction projects in our relevant markets and our strong market position. We continue to see strong growth in soil-dredge related bookings which have now increased more than 60% year to date. Clean Earth adjusted EBITDA increased 20% year-on-year and Clean Earth's margin reached 14% in the quarter. In addition to price and volumes, the business benefitted from favorable mix and internal cost efficiency initiatives compared with the comparable 2022 quarter.

Now please turn to Slide 7 for our revised 2023 outlook. And let me just highlight 2 points on this slide. First, Enviri's full year adjusted EBITDA is now expected to be within a range of $282 million to $289 million. Our new midpoint is up 24% year-on-year. Second, we now expect that our free cash flow will be between $25 million and $35 million for the year. The change in our free cash flow midpoint is attributable to higher interest and our updated view on working capital performance in HE.

As we've discussed in the past, HE customers in China have been slow to pay. We made good progress with certain China customers in the third quarter, but there is still more work to do here. As a result, some anticipated receipts have been pushed into next year.

Let me conclude on Slide 8 with our fourth quarter guidance. Q4 adjusted EBITDA is expected to range from $62 million to $69 million.

Harsco Environmental EBITDA is expected to increase significantly versus Q4 2022. Higher volumes, price and cost improvements will contribute to the growth. Clean Earth EBITDA is expected to be comparable to the prior year quarter. Here, higher price and improvements are expected to be offset by higher incentive compensation and operating expenses as well as professional fees.

Sequentially, results for both segments are anticipated to be lower due to seasonality and less favorable business mix. And lastly, corporate costs are projected to be approximately $10 million in Q4 with the increase versus the prior year driven by incentive compensation, higher professional fees and other various items.

Thanks, and I will now hand the call back to the operator for Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question comes from Rob Brown with Lake Street Capital Markets.

Robert Duncan Brown ***Lake Street Capital Markets, LLC, Research Division - Senior Research Analyst***

First on Clean Earth, you had very good margin improvement, and you've made good progress. Just wanted to get an update on your thinking on how much further you can take that. And what are sort of the pieces next year that you can do to get more margin improvement?

F. Nicholas Grasberger ***Enviri Corporation - Chairman, President & CEO***

Well, as we've highlighted for a few years now, the target EBITDA margin within Clean Earth, since the time of acquisition really has been 15%. And as we've noted, margins were 14% here in the third quarter. And we had some favorable mix driving that. The soils business, let's say, grew a bit higher than the hazardous waste business and the margin differential there is 4 or 5 points. So that's certainly helping. And the backlog is quite strong.

So we would anticipate that benefit continuing into next year. And many of these operational efficiency oriented projects will continue into next year as well. And I think we've learned that our pricing discipline and opportunity in this business is somewhat better than it has been in the previous few years. So I think we'll clearly provide a bit more guidance on what the expected EBITDA margin is for Clean Earth next year in February, but we're very pleased with the trends. And this 14% is the new high watermark and consistent with our plan from the beginning.

Robert Duncan Brown ***Lake Street Capital Markets, LLC, Research Division - Senior Research Analyst***

Okay. Great. And then switching to the environmental business. You talked a little bit about eco-product growth. Could you elaborate on how that's kind of going and what is that in terms of percent of mix and what you see that can do in terms of...

F. Nicholas Grasberger ***Enviri Corporation - Chairman, President & CEO***

So there are several components to that. We have a few businesses within HE that are somewhat unrelated to mill services. The Altek acquisition that we made a few years ago and the Reed Minerals business also part of part of HE, those 2 businesses, which are part of our eco-products portfolio, in particular, are doing well year-over-year. The eco-products business that's, let's say, contained within the steel mill service business is flat to slightly up year-over-year, really adversely affected by lower nickel prices and volume of onward sales of nickel scrap but overall, eco-products is having a very good year. And it's 15% to 20% of our business.

Operator

The next question is from Larry Solow with CJS Securities. Please go ahead.

Lawrence Scott Solow ***CJS Securities, Inc. - MD of Research***

Welcome, Tom. First question, just on environmental. I guess, like you mentioned, steel production has been weak this year, and I've not taking our production, over the last few years it actually been anything below sort of your customer production and below sort of industry averages. But you still managed to grow revenue 9% this quarter. Could you just speak to sort of some of the sources of revenue growth there? I know part of it is some price catch-up, but help us kind of parse out the differences there?

F. Nicholas Grasberger ***Enviri Corporation - Chairman, President & CEO***

Yes. So as we do every year, we have some new contracts, new sites that are coming online in the second half of the year, and that's certainly boosting revenue in Q4. Price as well continues to be a benefit for us year-over-year as we have compensated for inflation with price increases throughout this year. And then the -- just picking up on the eco-product theme, again, a few of those businesses in Q4 are growing.

So even though steel production is down on a continuing site basis, I guess the other factor that I think I mentioned earlier was that we've also been successful on existing sites, adding new services to the scope of the contracts and those services clearly leverage the infrastructure that we have on the sites. They tend to be less capital intensive and so very accretive to our returns on capital on these sites. And so that's helping as well, Larry.

Lawrence Scott Solow ***CJS Securities, Inc. - MD of Research***

Okay. Great. And then switching gears just to Clean Earth, which obviously has been a wonderful turnaround in the last several quarters, it has been performing well. And I think a lot of it has been done with not so much improvement on the soil side. I know that's a smaller part of the business, but obviously, you mentioned at least in the dredging and I guess the wet soils is up, bookings were up 80%.

Can you help us just -- that break it out specifically that 80% rise in bookings that eventually goes to sales. How -- what that means relative to the full size of Clean Earth and how much that can move the needle from a high level, not -- if you want to give me some specifics.

F. Nicholas Grasberger ***Enviri Corporation - Chairman, President & CEO***

So the soils and dredge business is 15-or-so percent of the Clean Earth revenues. You may recall from previous discussions that we've been waiting for some time for some of these infrastructure projects to begin and for that volume to flow into our facilities. And over the past few quarters, it has. We've seen record levels of increase in backlog that will extend, of course, into 2024 as well. So it's not 1 or 2 projects that are really driving this. It's a pretty broad-based improvement in projects starting.

And as I noted, the mix is favorable because the margins on this business tend to be 4 or 5 points higher than that in the hazardous waste segment of Clean Earth. And even within the soils business, there's a mix component that is running favorable now.

David Scott Martin ***Enviri Corporation - Director of IR***

And Larry, this is David. Just to clarify one point, you mentioned a 60% growth in bookings. That is mostly tied to dry soil as you label them as opposed to wet.

Lawrence Scott Solow ***CJS Securities, Inc. - MD of Research***

That will be more -- okay, not the dredging side. Yes. Okay. I appreciate that. And just on the hazardous side on the collection side, I know you guys -- there were some bottlenecks that you -- in terms of getting some of the stuff through it to the incinerators or the -- I think some of that goes to cement kilns, and if I'm not mistaken, is that kind of -- is that bottleneck in -- is that moving forward? Or I know that's actually hurt you guys a little bit, too, right?

F. Nicholas Grasberger ***Enviri Corporation - Chairman, President & CEO***

Yes, it's a good question, Larry, because certainly, it has been a challenge for us, but that recently is much less of a challenge. So I would say we're really not forgoing any revenue because of lack of disposal capacity.

Lawrence Scott Solow ***CJS Securities, Inc. - MD of Research***

Okay. And then lastly, on the Rail business, it sounds like things are outside of the higher interest rates, which is a macro issue, obviously. Feels like things are progressing, and you sound like confident you'll have the sale within the next 1 to 2 quarters. In terms of the derisking of the long-term contracts, I know you updated us last quarter. I think there were 2 kind of outstanding kind of issues or 2 separate customers. I felt like one was moving forward. Any update there just in general?

F. Nicholas Grasberger ***Enviri Corporation - Chairman, President & CEO***

Yes. So we -- you may recall, I think we noted in the second quarter, we had successfully renegotiated and amended the contract with 1 large European customer, and we're in the process of doing the same with another. And -- but we do have a number of these long-term contracts, they're complex. The supply chains are complex. The diligence on those contracts takes time but yes, the process is certainly moving forward.

Operator

The next question is from Aadit Shrestha with Stifel.

Aadit Shrestha ***Stifel - Analyst***

Just following up on the Rail. Is that the run rate EBITDA back to pre-COVID levels now? Or are we looking at that getting back there in 4Q '23 because I think you mentioned you do expect a great performance from Rail. And then also just maybe could you talk about what is holding up the final agreement at this point, potential buyers that are in place? Just more about that would be great.

F. Nicholas Grasberger ***Enviri Corporation - Chairman, President & CEO***

Sure. Yes. So I would say that the core business outside of the long-term contracts is approaching where it was pre-COVID, it's not quite there, if you look at the fourth quarter. This will be the strongest fourth quarter we've had in the Rail business in the core business in some time and clearly back to pre-COVID levels. And the view for next year is quite healthy, and we see a lot of that in backlog today.

So we feel quite good about the core. As I noted just a minute ago, these long-term contracts in Europe are large. They're complex. The supply chains are very complex. You can imagine, during COVID, the disruptions to that supply chain, you can also imagine the impact of inflation on those contracts over the past couple of years. So the process of renegotiating on our side and on the buyer side conducting diligence and understanding the risks on these contracts takes time, longer than we'd like, but it is what it is. And so I don't think there's a question of if we'll get to a deal late this year, early next year, but simply a matter of when. And again, as I mentioned, I think the fourth quarter, which we expect to be strong will help the process.

Aadit Shrestha ***Stifel - Analyst***

Great. And just switching gears, I guess, sort of still related to Rail, but I think you talked about leverage, you expect it to come down further 0.5 a turn in FY '24. So potentially exits FY '24 at 4x for Rail sale. Are you assuming any sort of pay down of debt in that? And how much further can leverage come down after the Rail sale? Does it come down 0.5 more turns? So you're potentially exiting FY '24 at 3.5x leverage?

F. Nicholas Grasberger ***Enviri Corporation - Chairman, President & CEO***

Yes. I think certainly, excluding the impact of the Rail divestiture, we should be well below 4x by the end of next year. And we do expect the rail transaction to be a delevering event. So I won't give a specific number now. We'll have much better view in February when we have our next call, but that 1/2 turn plus of incremental deleveraging next year plus the impact, the delevering impact of the Rail divestiture will certainly put us well below 4x.

Aadit Shrestha ***Stifel - Analyst***

Great. And then just last one for me. So you did raise the EBITDA guide for $10 million. Just -- and then I think -- I'm sorry, free cash flow was lowered by $10 million, but then you raised the EBITDA by $8 million. So what accounts for that sort of a lower free cash flow and raise in EBITDA?

F. Nicholas Grasberger ***Enviri Corporation - Chairman, President & CEO***

Yes. It's really a function of receivables in China. We came into this year with, I'll call it, a $50 million challenge. We're kind of $35 million through that. And we have $15 million that's being pushed into Q1. And so again, this is not a situation where there's a question of whether it's collectible, it's just a matter of when. And there are a few contracts -- contractual matters that need to be resolved and they will. And I see this $15 million or so that we had assumed that we would collect in the fourth quarter, we'll be -- we'll see that in Q1.

Operator

(Operator Instructions) The next question comes from Davis Baynton with BMO Capital Markets.

Davis Robert Baynton ***BMO Capital Markets Equity Research - Associate***

This is Davis on for Devin Dodge. So in the previous year, you had mentioned some lost revenues from a lack of staffing in Clean Earth, but this seems to have improved in 2023. Are labor conditions continuing to accelerate there? And maybe what's your current outlook in the Clean Earth's labor conditions?

F. Nicholas Grasberger ***Enviri Corporation - Chairman, President & CEO***

Yes. I think you're referring as many other companies did to the shortage, the rather acute shortage of truck drivers that we had in Clean Earth last year. That was one of many challenges we had, coupled with inflation and logistics costs and diesel prices and so forth. But yes, that was a challenge for us last year. I won't say that we're fully staffed to the level that we'd like with respect to drivers, but we are in a much, much better position than we were in previous quarters. So I really don't believe that we're losing much in terms of revenue or profit based on the labor situation.

Davis Robert Baynton ***BMO Capital Markets Equity Research - Associate***

Okay. And then just switching over to Harsco Environmental. So you had -- you've already talked a bit about the weaker-than-expected steel production by customers in that segment. But maybe could you please just expand a bit about what your steel mill customers are saying in terms of near-term production levels? And how much visibility do you have into that business?

F. Nicholas Grasberger ***Enviri Corporation - Chairman, President & CEO***

Yes. Well, first of all, let me just comment on the mix within HE. Certainly, some geographies are growing quite nicely, India. We're the only mill service provider in India. And India is growing quite well. We've seen reasonable growth in China this year. We've seen good growth in Turkey. It's really the Americas and Western Europe that have kind of held us back. Fortunately, our -- the margin differential is weighted -- the higher margins are weighted towards the developing markets that are doing relatively better than Europe and the U.S.

In terms of visibility, we, of course, follow many different forecasts for steel production. We listen to our customers as well. We thought coming into the second half of the year that we -- this year, we'd see a bit of an uptick, and it just hasn't happened. And so we thought we'd be plus 1% or 2% in the second half of this year versus second half of 2022. And in fact, it's been down a bit.

Most forecasts that we see in most of our customers, as we discuss 2024, do expect volume growth. If you look at steel mill capacity utilization at least at the mills that we support, if you take out the first half of 2020 is kind of at a 10-year low. And so we certainly expect that to improve. Our customers do, economists do and so we do anticipate growth in 2024.

Operator

This concludes our question-and-answer session. I would now like to turn the conference back over to Dave Martin for any closing remarks.

David Scott Martin ***Enviri Corporation - Director of IR***

Thank you, Debbie, and thank you to everyone that joined this call. Please feel free to contact me with any follow-up questions. And as always, we appreciate your interest in Enviri and look forward to speaking with you soon. Thank you.

Operator

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.