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Q2 2023 Enviri Corp Earnings Call

EVENT DATE/TIME: AUGUST 02, 2023 / 1:00PM GMT

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PRESENTATION

Operator

Good morning. My name is Desiree, and I will be your conference facilitator. At this time, I would like to welcome everyone to the Enviri Corporation Second Quarter Release Conference Call. (Operator Instructions) Also, this telephone conference presentation and accompanying webcast made on behalf of Enviri Corporation are subject to copyright by Enviri Corporation and all rights are reserved. No recordings or redistributions of this telephone conference by any other party are permitted without the expressed written consent of Enviri Corporation. Your participation indicates your agreement. I would now like to introduce Dave Martin of Enviri Corporation. Mr. Martin, you may begin your call.

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

Thank you, Desiree, and welcome to everyone joining us this morning. With me today is Nick Grasberger, our Chairman and Chief Executive Officer; and Pete Minan, our Senior Vice President and Chief Financial Officer. Please note that we are doing this call from different locations today, so please bear with us as we transition between speakers and address your questions.

This morning, we will discuss our results for the second quarter and our outlook for the remainder of the year. We'll then take your questions. Before our presentation, however, let me mention a few items. First, our quarterly 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, please see the Risk Factors section in our most recent 10-K. The company undertakes no obligation to revise or update any forward-looking statements. 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 today 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. We delivered a strong second quarter with revenues and adjusted EBITDA exceeding forecasts across our continuing segments, Harsco Environmental and Clean Earth. Revenues were up 8% and adjusted EBITDA increased over 50%. This better performance is attributable to several pricing and cost initiatives in both divisions as well as increased operating efficiencies and improvements in some end markets.

As a result, after lifting our outlook for the year last quarter, we are once again raising our full year outlook this quarter. Additionally, our leverage, which was below 5x at the end of the first quarter continues to decline and sits at 4.6x, and I believe the figure should decline to 4x at year-end.

Before adding further commentary on our performance, there are a few items of note that I want to discuss. First, we have initiated the process of selling our Rail segment and have started reaching out to selected, potential, strategic buyers. This is a priority for both the Board of Directors and management. We expect to sell the business by the end of the year. And as I've mentioned, one of the necessary steps to selling the business is reducing the risk associated with our long-term contracts.

We've taken a significant step in that regard by successfully amending the Network Rail stoneblower manufacturing contract, the effect of which was a favorable modification of our delivery schedule and a reduction in our financial exposure. I should also note that the underlying business continues to perform ahead of our plan and well ahead of last year. Second, we successfully resolved our dispute with Stericycle during the quarter regarding price increases. Both parties are satisfied with the result, and I'm pleased that the settlement was amicable.

We have an even stronger relationship with this customer and continue to provide Stericycle exceptional service. Next, as you are no doubt aware, on June 5, we changed our name to Enviri. A new name and brand identity reflect the company's transformation over the past few years into a single-thesis environmental solutions company, one that provides services to manage, recycle and beneficially reuse waste and byproduct materials across many industries.

As we considered how our business has evolved and our commitment to the environment, it is important to have a name and brand identity that align with that image. We are energized by this change and look forward to continuing to operate with the same commitment to excellence that has been part of the company's legacy for more than 170 years.

Finally, in late June, we announced that Rebecca Martinez O'Mara was elected to Enviri's Board of Directors. We're committed to refreshing our Board, and Rebecca is the third new director in the past 18 months. During her 30-year career, she worked in executive positions for a series of industrial and manufacturing companies, including Stanley Black & Decker, Caterpillar, Fiat Industrial and AT&T. In particular, her experience and leadership in business transformations and promoting cultural diversity will be of great value to us.

I'll now provide a few comments on each of our segments. At Harsco Environmental, we effectively manage the business in the face of lower steel production, particularly in Europe and Latin America compared to last year at this time. Strength in India and Turkey partially offset this effect. And despite the lower volumes, the steel mill service business and certain ecoproducts businesses performed better in the quarter. We continue to expect full year EBITDA in HE to be modestly above last year's figure with higher EBITDA margins and free cash flow generation near $100 million.

We continue to limit growth capital in HE only to opportunities that provide a strong risk-adjusted return. More broadly, the competitive position of HE remains quite strong. We continue to renew contracts successfully and initiate price increases to offset inflationary pressures. We look forward to the impact that our operating leverage will have on earnings and cash flow as steel production volume returns to more normalized levels.

At Clean Earth, this segment delivered its fourth consecutive quarter of 12%-or-so EBITDA margins. We expect margins in Clean Earth to remain strong for the remainder of the year as we continue to progress towards our 15% EBITDA margin target. It's also important to highlight that Clean Earth is a capital-light business with cash flow conversion this year expected to be roughly 85% of EBITDA.

Pricing improvement initiatives as well as higher retail and health care volumes support our strong results. Underlying the financial performance is much improved operational performance as well, namely service levels, safety and labor efficiency. Overall, there's no doubt that the segment is back on track to deliver on the promise to create shareholder value from the acquisitions made a few years ago to create our Clean Earth platform.

Finally, I'd like to discuss our PFAS initiatives. Within Clean Earth, we continue to see PFAS remediation work as a significant opportunity as related litigation continues, management budgets increase, the body of supporting technical data expands and federal and state regulations are finalized. Our approach anticipates using the toolbox of technologies to address each customer specific requirements that will vary based on risk and economics to provide a more sustainable and resource-friendly solution than landfills, incineration or deep well.

We see soil and water as the 2 major market opportunities that align with our national footprint, which includes both fixed base and mobile thermal desorption and oxidation assets. We're actively working with identified public and private partners to pilot our existing thermal capabilities and to expand our water treatment technologies to couple with our hazardous wastewater treatment facilities. These new and existing technologies are undergoing internal trials with anticipated testing and evaluation by the DoD, the EPA and various state environmental agencies to follow.

We were encouraged by the recently published DoD interim guidance on PFAS, in which the DoD highlights that a state permitted destruction technology could be considered rather than a hazardous waste incinerator. For example, as the memo states, a state-permitted thermal desorption unit could be considered.

So in summary, it was another strong quarter for Enviri and a very good first half of the year. In the second half, we will focus on the Rail divestiture and continuing to capitalize on the operational and financial efficiencies at Harsco Environmental and in Clean Earth, including cost savings and a pricing escalation strategy.

I'll now turn the call over to Pete.

Peter Francis Minan ***Enviri Corporation - Senior VP & CFO***

Thanks, Nick, and good morning, everyone. So please turn to Slide 4. Enviri's second quarter consolidated revenues from continuing operations increased to $520 million, up 8% compared with the prior year quarter. The increase was primarily driven by pricing as well as increased demand within both our Clean Earth and Harsco Environmental segment.

Adjusted EBITDA totaled $78 million, which is above our prior guidance range and this represents a 58% improvement from the prior year and a 24% improvement sequentially.

Both of our segments realized stronger-than-anticipated performance. Clean Earth results were better than expected due primarily to the inclusion of the impacts realized from our recent Stericycle agreement. Clean Earth also benefited from stronger volumes in its retail and its soil dredge businesses as well as lower operating costs for containers, disposal, labor and energy across the business. For Harsco Environmental, results were higher than anticipated due to better services demand despite lower customer production as well as favorable pricing.

Relative to the prior year quarter, the consolidated EBITDA increase was largely driven by Clean Earth as a result of price increases, internal efficiency initiatives, lower operating costs and higher volumes. Harsco Environmental results also improved modestly against the prior year. Our adjusted earnings per share was $0.01 for the quarter, which also compares favorably to our May guidance. Free cash flow for the quarter was a negative $23 million. Relative to the second quarter of 2022, the change reflects the benefit of our accounts receivable securitization transaction in 2022 and the timing of certain payments from Q1.

Also higher cash interest and capital spending impacted free cash flow. Importantly, operating cash flow performance within Harsco Environmental and Clean Earth was positive. And our consolidated free cash flow performance for the quarter was consistent with our expectations. We expect our cash performance to improve for the balance of this year.

Lastly, due to strong operating performance, our net leverage decreased to 4.6x at quarter end, and we are confident that our leverage will decrease to near 4x at year-end before considering the benefit of asset sales.

Please turn to Slide 5 in our Environmental segment. Segment revenues totaled $290 million, up 6%, excluding the impact of foreign exchange translation. Adjusted EBITDA reached $53 million for the quarter. Relative to the prior year quarter, Harsco Environmental benefited from higher ecoproducts and services demand as well as higher pricing and cost improvement initiatives. These positives were partially offset by lower commodities prices and foreign exchange, which negatively impacted results by approximately $5 million in the quarter.

Overall, we're pleased to see that HE performed well despite lower steel production at customer locations due largely to operational improvements, other services performed and a favorable mix. Of note, steel output at our customer sites decreased approximately 6% year-on-year and was little changed sequentially. Regarding our improvement initiatives, Q2 results were supported by our cost reduction program which is on pace to realize the anticipated benefits of $10 million annually. And our focus on strengthening performance at a small number of sites is driving positive actions with benefits expected to increase as the year progresses.

Next, please turn to Slide 6 to discuss Clean Earth. For the quarter, revenues totaled $231 million and adjusted EBITDA was $35 million. Compared to the second quarter of 2022, revenues increased 13% primarily as a result of price increases and the Stericycle settlement. Volumes were only modestly higher as strength in retail, health care and infrastructure was offset by softness and project timing in manufacturing and industrial.

Hazardous materials revenues reached $198 million, up 15% year-over-year, while soil and dredge revenues totaled $33 million for the quarter. Clean Earth's adjusted EBITDA increased $30 million year-on-year, and Clean Earth's margin reached 15% in the quarter. In addition to price and volumes, the business is benefiting from internal initiatives and lower operating costs. The positive impact from these internal initiatives is running roughly $3 million per quarter with much of the benefit attributable to logistics and labor savings.

Clean Earth is also seeing incremental benefits from lower container and transportation costs. Now before turning to our outlook, let me comment briefly on the Rail business. As Nick mentioned, we recently renegotiated our equipment supply contract with Network Rail. We have now extended and redefined the delivery schedule for the machines into 2025 and therefore, reduced our estimate of the liquidated damages due under the contract. For the benefit of our customer, we have also dedicated specific additional capacity to manufacture the equipment. This amendment is a very important milestone for Rail as it helps to reduce the financial risk associated to our long-term contracts.

Now please turn to Slide 7 for our revised 2023 outlook. And note that our detailed segment outlook can be found in the appendix of our slides. Enviri's full year adjusted EBITDA is now expected to be within a range of $270 million to $285 million. This compares to the prior range of $260 million to $275 million with our new midpoint up 21% year-on-year. This revised EBITDA guidance translates to an adjusted loss per share of between $0.09 and $0.25. Lastly, we now expect that our free cash flow will be between $30 million and $50 million for the year.

Now let me conclude on Slide 8 with our third quarter guidance. Third quarter adjusted EBITDA is expected to range from $67 million to $74 million. At the midpoint, Harsco Environmental's EBITDA is expected to increase compared to the prior year quarter due to higher contributions from ecoproducts, new contract additions and internal improvements.

Clean Earth results are anticipated to be similar to the prior year as price, higher volumes and operating improvements will be offset by labor and disposal cost inflation and higher incentive compensation. Sequentially, for Clean Earth, the adjusted earnings comparison will be impacted by the Stericycle settlement in the just completed quarter. And lastly, corporate costs are projected to be between $11 million and $12 million for the third quarter.

Thanks, and I'll now hand the call back to the operator for questions and answers.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question comes from Larry Solow with CJS Securities.

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

Great Just I guess -- just a couple on the Rail. So I guess the agreement that you reached now with Network Rail. Was it just a major sort of -- major obstacle in terms of contracts that issues you had? Or are there still others that you kind of feel like you need to resolve?

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

Yes, it's a good question, Larry. Yes, there are a few others, one in particular, in Germany that we are working to resolve kind of as we speak. In effect, the way we're marketing the business is the -- kind of the core of the business remains very strong, good margins, demand is increasing well above last year. A few of these longer-term contracts, as you know, were affected by supply chain challenges and inflation about a year ago.

And so we've been working hard both operationally and in terms of our agreements with our customers to kind of reduce the risk of the range of outcomes from those contracts over time. And we've done a lot of that work, most notably the Network Rail contract that Pete and I mentioned, but there are others as well.

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

Okay. And I guess the improved performance. That's mostly domestic or other international contracts, I guess, supplies and all of those? Supply chain side, I imagine is getting better for you guys. So at those contracts actually the work stopped until some of these things were settled and most of the...?

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

No, no we're continuing to -- yes, we're continuing to fulfill those contracts. But what's stronger is the standard equipment, the aftermarket business, the contracted services, the technology piece, those core elements of the business are doing quite well versus plan and also versus last year.

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

Got it. Great. And on the environmental piece, just obviously, you continue to perform well in a pretty difficult environment, kind of somewhat lackluster steel production volumes. Can you just speak to sort of some sort of growth opportunities as you look out whether it be new projects, new customers or potentially maybe more importantly with less CapEx. Just expanding services at existing customers. I think that's sort of been something you guys are sort of driving towards. Maybe update us on that.

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

Yes. Well, first of all, I'd say that capacity utilization in steel mills, if you exempt the first half of 2020 is at its lowest level in about 10 years. So we think there's a good bit of volume uplift potential here in the next couple of years. And given our cost structure and our operating efficiency, that's going to yield a pretty high fall-through to EBITDA and cash flow.

Beyond that, and we saw that the first half of the year, our non-steel production-based services are doing quite well and offsetting and mitigating the impact of lower steel production. So I would expect that to continue to ramp over time. And of course, there's much less capital associated with those services, so that will lead to better returns on capital. And then as we also noted, there are a handful of very attractive growth opportunities that have good returns that you'll see us executing over the next year or 2. So I think those 3 components are going to lead to a pretty healthy outlook for EBITDA and cash flow growth in HE.

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

Got it. And if I could just sneak one more in. Just on -- congrats on the settlement with Stericycle. It's good to get that behind you and it looks like it's beneficial. Was that the -- it feels like that's kind of the driver for the beat in the quarter and the predominant for the rates for the year...

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

Yes, certainly was a component of it. I think we -- the midpoint of our range has increased by about twice what that settlement value was in the quarter. And we were kind of at or a little bit above the high end of our guidance on EBITDA, if you exclude the Stericycle benefit in Q2.

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

Right. But wouldn't some of that settlement then carry forward in higher EBITDA going forward, right? That's why I was kind of adding that the settlement plus the next couple of quarters in '23, right, would be getting higher?

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

Yes. So part of the settlement was an incremental price increase this year and then next year as well. So yes, there's a little bit of a tailwind as well on top of the $6 million from a midyear price increase.

Operator

Our next question comes from Rob Brown with Lake Street Capital Markets.

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

Just wanted to follow up on the kind of the price realization comments that you talked about in Clean Earth. You said that there's a pending price increase. I guess have you -- where are you at in terms of getting your price increases there? And how much is left to go? Could you clarify that?

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

Is the question related to Stericycle or more broadly?

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

More broadly.

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

Yes. So as you know, we moved quickly and I think aggressively this time last year to increase prices to offset the unprecedented inflation that we saw in the Clean Earth business. And then at the beginning of this year, we instituted our more standard annual price increases across the book.

And selectively, throughout this year as certain inflation components move ahead of expectations, we are raising price as well. But for the most part, the benefits that you're seeing in price in Q2 were a result of the midyear price increase last year and the price increase again early this year. But I would anticipate going forward, the price increases will more likely be an annual event.

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

Okay. Good. And then I think you mentioned some kind of mixed kind of end market demand environment. But how is the demand environment looking for Clean Earth over the next sort of 12 months? And what markets are you seeing some -- I think you mentioned a little bit of weakness in housing, but where are you seeing sort of the strength and weakness in Clean Earth?

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

Yes. So kind of in order of performance, health care is probably the best-performing segment of our end market, followed by retail and then industrial. Now industrial was a little weaker in the quarter, but that was driven by the so-called project work, think of a hand sanitizer project. I think the underlying demand in Industrial is still healthy when you strip out the impact of the somewhat lumpy project work on a quarter-to-quarter basis.

In the soils business, the bookings in that business this year are the highest level we've seen since we made the acquisition a few years ago. Most of that is yet to flow through to revenue because the projects have yet to begin, but the outlook for soil and dredge is quite good not only in terms of volume, but the mix in the soils business is improving.

Operator

(Operator Instructions) Our 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 you've made a lot of progress on restoring the profitability of Clean Earth, and I know you've touched on this a bit, but I'm just wondering if you could expand a little bit on what the drivers are that can push that that -- the underlying EBITDA margin to that 15% goal. And then maybe what's a reasonable time frame for that?

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

Yes. So first of all, I'd say just the operating leverage that will apply to volume growth in the business, which we expect to be kind of low to mid-single digits. So that would be a component of it. Secondly, the overhead in the business, in my view, was still elevated based on a series of processes and systems that are just highly inefficient and very labor intensive.

So we would anticipate over the next 2 years, another significant reduction in the overhead structure. We've reduced the overhead a few times since we acquired it, but there is another significant reduction that we believe will execute in the next, say, 18 to 24 months.

Third, I would say that as we've seen over the past year our ability to improve margin through price and mix is encouraging. At this point, we have gone beyond recovering cost inflation with price and margins are now higher because of that on a net basis.

Third, from a mix standpoint -- or fourth, I should say, the mix -- the margin on the soils business is higher than that on the hazardous waste business at least at this point. And I think the volume growth potential in soil because of the PFAS volume, I think, is fairly significant. So that should lead to higher margins as well. And there are, of course, a few other items. But I would say that to get to 15% in the next 18 to 24 months would certainly be our target, and I think quite realistic.

Operator

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

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

Thank you, Desiree, and thank you for everyone joining us. Feel free to call me with any follow-up questions. And again, as always, we appreciate your interest in Enviri, and we'll speak to you soon. Thank you.

Operator

Thank you for attending today's presentation. You may now disconnect.