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PRESENTATION

Operator

Good morning. My name is Dedra, and I'll be your conference facilitator. At this time, I would like to welcome everyone to the Harsco Corporation second quarter release conference call. (Operator Instructions) Also, this telephone conference presentation and accompanying webcast made on behalf of Harsco Corporation are subject to copyright by Harsco Corporation, and all rights are reserved.

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I would now like to introduce Mr. Dave Martin of Harsco Corporation. Mr. Martin, you may begin your call.

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

Thank you, Dedra, and welcome to everyone joining us this morning. I'm Dave Martin, Director of Investor Relations for Harsco. With me today is Nick Grasberger, our President and Chief Executive Officer; and Pete Minan, our Senior Vice President and Chief Financial Officer.

This morning, we will discuss our results for the second quarter of 2018 and our updated outlook for the year. We'll then take your questions. Before our presentation, however, let me highlight a few items. First, a PDF of our earnings release as well as a slide presentation for this call have been posted to our website.

Second, this call is being recorded and webcast. A replay will be available on our website later today.

Third, 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 expectations, knowledge and are subject to certain risks and uncertainties that may cause actual results to differ from these 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.

Fourth, 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 our slide presentation today.

Lastly, note that Nick, Pete and I are in different locations today, so please bear with us through any transition and communication challenges.

Now I'll turn the call over to Nick to begin his remarks.

F. Nicholas Grasberger - *Harsco Corporation - President, CEO & Director*

Thank you, Dave. Good morning, everyone, and thank you for joining us. I'm very happy to say that we delivered another strong quarter, exceeding our profit guidance and reaching the highest adjusted operating profit margin in over a decade.

Each business segment achieved a double-digit margin. We've also raised our profit outlook for the full year. Finally, and perhaps most importantly, we now expect our return on capital to exceed 15% for 2018, that's 3x higher than a few years ago, and the highest at Harsco in over a decade as well.

We believe this reflects smart and disciplined capital allocation. We're focused on cost that has yielded more efficient operations and foundational improvements in a few of our historically challenged businesses.

In short, we entered the second half of the year confident in the prospects of each of our businesses. As our outlook indicates, we anticipate a strong end to 2018 with that momentum continuing through 2019.

Through the combination of supportive end markets, a healthy balance sheet and a stable and talented management team, we are well positioned to execute our strategic growth plans. This includes investing in both internal initiatives as well as in targeted acquisitions, while maintaining the flexibility to return capital to shareholders as and when appropriate.

I'll make just a few brief comments on each segment and then turn the call over to Pete. Our Metals & Minerals segment delivered another strong quarter as a result of high steel output and services and new growth contract as well as increased Applied Products sales, which, as you know, is a critical component to our growth strategy.

Importantly, if you adjust our operating income for the investments we've made this year, our profit growth in M&M is a good bit higher.

I'd like to also provide an update on some of the key initiatives and themes that I discussed last quarter. I mentioned on our last earnings call, that M&M is pursuing new relationships at a pace not seen in the past. This year, we've expanded our investments in innovation and added commercial resources to these efforts.

As we look towards 2019, we expect a healthy lift in revenues due to these investments and several new contracts across all regions that will commence in the first half of the year.

We also took a strategic look at what skills and experiences would strengthen our M&M team and, as a result, we've recently added a talented executive to serve as the Chief Operating Officer of M&M, while also adding staff to the business development functions.

Finally, I discussed our aspiration to transform M&M into a global leader in providing environmental solutions to basic industries beyond the steel industry.

In May, we took the first step with the acquisition of the Altek Group, a U.K.-based manufacturer of market-leading products that help aluminum producers and recyclers better manage their waste streams.

This is the first significant investment for M&M in more than a decade, and we are in the process of integrating Altek into our business.

It fits perfectly into our strategy of developing a premier environmental solutions platform beyond our core industry. Our Industrial segment reported an excellent second quarter, revenues increased 25% due to increased demand and higher prices, while operating income increased more than 50% as a result of favorable product mix and improved operational efficiency.

All three Industrial businesses demonstrated strong organic growth and operating leverage improvement in the second quarter over the prior year. Notably, Air-X-Changers upstream and mid-stream products continue to show considerable strength with revenue up nearly 50% compared to second quarter of last year, and the highest bookings run rate since early 2014.

We also continued to gain momentum in capturing market share for a handful of product lines from key competitors that are positioned further downstream. Our Industrial backlog is up 60% versus second quarter of 2017 and up 20% versus first quarter of this year. We expect this momentum to continue into the third quarter across all three Industrial businesses.

In our Rail segment, our results and overall market conditions indicate that we've turned the corner. And we expect a strong second half and an even stronger 2019. The combination of improving end markets and a strengthened management team that has instituted a much more focused strategy and process orientation have together led to significant growth in our backlog and coding activities. This is, coupled with an exciting pipeline of new products, which are truly innovative and will provide compelling value propositions to our customers around the world.

And similar to our other two segments, we also anticipate investing in other businesses to broaden our technology and market access in the Rail business.

So I'd like to, as always, thank you for your support and your interest in our company. And I will now ask Pete to provide further perspective.

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

Thanks, Nick, and good morning, everyone. Let me also echo what Nick just said, we're very pleased with the results this quarter and our revised outlook for the full year. So let me start with Slide four. Harsco's adjusting operating income in the second quarter was $52 million. This result exceeded our guidance range for the quarter of $45 million to $50 million. Among our operating businesses, Rail was the largest contributor to our outperformance in the quarter. In North America and Asia, our sales and product mix of Rail equipment and aftermarket parts were better than anticipated.

Some of these benefits were timing related. We're starting to see some evidence of emerging momentum within North America and Rail industry. And after a few difficult years in this market, the positive trend is certainly welcome, and great to see.

This market development, coupled with our internal execution led to a healthy growth in our Rail backlog in the quarter, which I'll touch on later.

Secondly, results in our Industrial segment were, again better than expected and the trends across all of our Industrial businesses remained very positive. We experienced a nice margin expansion in our metal grating business, while the strength in Air-X-Changers continues to remain the highlight.

Our customer order activity was quite strong through the quarter, and our visibility for the next few quarters has improved. Unlike Rail, our backlog in Industrial also increased nicely in the quarter with strong bookings.

Lastly, relative to guidance for the quarter, our corporate spending was, again, lower than we forecasted, partially due to the timing of some expenditures. As Nick said, our adjusted operating income of $52 million represents Harsco's highest profitability in a number of years. The same is true with our adjusted operating margin in the quarter. Our adjusted margin was 11.9%, and each segment reported a double-digit margin in second quarter.

Revenues in the second quarter totaled $432 million, an increase of 9% compared with the prior year quarter. Once again, our Industrial segment realized the highest year-on-year growth rate. The top line growth led to a 20% increase in our adjusted operating income, with each segment realizing higher earnings versus the second quarter of 2017.

Our adjusted earnings per share was $0.36 compared to our guidance range of $0.30 to $0.35. This EPS figure also represented a 64% increase over the comparable period of 2017.

In addition to stronger operating performance, EPS was driven by lower interest costs and a lower effective tax rate. We did have a few unusual items in the quarter, which all told, had a net positive impact to our operating income and earnings per share as reported. This included Altek acquisition costs of $1.2 million; expenses to reprice and amend our credit facility of $1 million; a positive deferred tax valuation allowance adjustment also linked to Altek acquisition of $8 million; and we had some favorable developments resulting in the reversal of an expense accrual in M&M by $3 million.

And as a result, Harsco's GAAP earnings per share in the second quarter was $0.48. Free cash flow in the quarter totaled $28 million, which represented a sizable improvement over the first quarter of this year. Compared with the 2017 quarter, a slight decline can be attributed to higher capital expenditures.

Looking forward, we anticipate that our free cash flow will be very strong in the second half of this year, as is traditionally the case each year. So let me get into the segments, starting on Slide five.

In the second quarter, revenues in the Metals segment increased 5%. This growth is actually 10%, if you exclude the impact of exited site revenue. And our adjusted operating income increased to $33 million from $31 million in the prior year. These increases are attributable to higher steel output and services demand as well as higher contributions from certain Applied Products businesses.

Steel output at customer sites rose approximately 4% in the quarter. Also, net contract growth had a positive impact on operating income in second quarter. As you are aware, we are now investing for growth in winning new business. The impact of net contract changes turned positive a couple of quarters ago for M&M, and we expect it to remain positive and increase in the future.

These positives were partially offset by planned growth relating investments, which totaled approximately $2.5 million in the quarter.

Also, as you are aware, we acquired Altek Group near the end of May. While its impact on the quarter's results is not material, the integration process is moving forward smoothly. We're excited about the benefits this acquisition will provide to Harsco as well as our customers. And lastly, Metals adjusted operating margin reached 12.2% in the second quarter.

Turning to Industrial on Slide Six. Revenues increased 25% for this segment versus the comparable period in 2017, while operating income rose over 50% compared with the 2017 quarter. Each of our three product businesses within Industrial realized revenue and income growth in the quarter. These changes reflect the positive demand trends, higher product prices and improved margins. As a result, the segment's operating income margin increased to 15.4% from 12.6% in the prior year period.

Also, as mentioned earlier, customer bookings and backlog trends were very positive in the second quarter. Bookings across the segment rose approximately 40% versus the second quarter of 2017 and our backlogs grew 20% quarter-over-quarter and reached over $130 million with most of that backlog maintained within our Air-X-Changers business. Air-X-Changers continues to perform well and realized strong margins, illustrating the benefits of manufacturing improvements we've implemented in recent years.

Now for the Rail segment, on Slide seven. Revenues in the second quarter increased 9%, mainly due to the recognition of SBB revenue in the quarter, which as we've noted before, has zero margin. Beyond the SBB impact, higher revenues from aftermarket sales were offset by lower equipment sales outside North America and lower contract services sales. These trends, along with product mix and lower SG&A, contributed to a slight increase in operating income relative to the prior year quarter. Operating income totaled $9 million versus $8 million in second quarter 2017, and Rail's operating margin reached 14%, excluding the effect of the zero margin SBB revenues.

Regarding our SBB contracts, we continue to make steady and positive progress against our commitments to this customer. 12 of the 13 base vehicles have been handed over to SBB under the first contract, equipment is performing very well and SBB remains pleased with the capabilities of the machines.

With respect to the second contract, we expect to lockdown the design of the vehicles during the second half of this year.

As I alluded to earlier, customer bookings and backlog growth was positive in the second quarter. Orders increased over 20% year-on-year, represented our highest quarterly total since early 2014. Our largest wins in the quarter were an equipment order with the U.S. Metro and a relatively large equipment sale into Southeast Asia. As a result, our backlog stands at roughly $280 million.

Turning to Slide eight, and our latest 2018 outlook. Let me highlight a few key items. First, our full year adjusted operating income guidance has increased to a range of $175 million to $185 million. This compares to $165 million to $180 million previously.

Likewise, our forecasted adjusted earnings per share is now expected to be between $1.19 and $1.27 per share as compared to a prior range of $1.11 to $1.24.

These outlook changes are being driven primarily by our Industrial and Rail segments as well as Corporate. For Industrial, our visibility and confidence has improved as mentioned earlier. As a result, operating income for this segment is now projected to increase roughly 45% versus 35% previously. For Rail, higher contributions from aftermarket and a more favorable product mix support a better outlook. Net corporate spending for the year is now expected to be similar to the prior year. Free cash flow guidance is raised to a range of $90 million to $100 million. As we mentioned in our last quarterly call, at this point, we don't expect any material impact from input cost inflation as a result of higher commodities and labor costs across our businesses. However, we'll continue to monitor this closely. One item that has somewhat of a negative impact is the movement in FX rates. A stronger U.S. dollar has impacted our expectations for the year's operating income by a few millions dollars versus our expectations a few months ago.

Overall, FX is now expected to be neutral to our revenue and earnings for the full year as compared with 2017. A summary outlook for each of the businesses is included in the presentation appendix.

So let me continue with some comments on the third quarter, on Slide nine.

In thethird quarter, we expect operating income to be between $50 million to $55 million as compared to adjusted operating income of $39 million in the third quarter of 2017. Also, diluted earnings per share is projected to increase to be between $0.34 and $0.40 per share as compared with adjusted earnings per share of $0.20 in the prior year quarter.

As was the case in the second quarter, each of the company's segments is projected to realize an improvement in profitability versus the third quarter of 2017.

Rail earnings are expected to increase significantly versus the prior year quarter, due to higher contributions from aftermarket, equipment, Protran products. Because of the timing of shipments in Rail, we anticipate that Rail's total earnings for the third quarter of this year will be similar to the fourth quarter of last year. We expect M&M to benefit from higher service levels and Applied Products contributions as well as new contracts. These positives are expected to offset our growth investments and FX impacts.

Industrial results are anticipated to increase from the prior year quarter due to improved demand. And note that our guidance takes into account a $4 million gain in the third quarter of 2017, and it will not be repeated this year.

Lastly, before we take your questions, we ended the quarter with a net debt position of approximately $600 million and a leverage ratio of 2x after the Altek acquisition. During the quarter, we were pleased to lower the interest rate, on our term loan by 75 basis points. This change lowers our annual interest costs by $4 million, which is a nice incremental benefit over the repricing benefits we realized in late 2017.

We also increased our credit capacity by $100 million, giving us added flexibility as we execute our strategy, including making growth investments across our segments.

At the end of the quarter, as a result, Harsco's liquidity exceeded $400 million. We expect to end 2018 at or near a leverage ratio of 1.5x. We anticipate using our free cash flow in the second half of this year to support our growth objectives, reduce our debt and return some capital back to shareholders with stock repurchases.

So that concludes our prepared remarks. And at this point, we'd be happy to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And your first question comes from the line of Robert Brown with Lake Street Capital Markets.

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

First, I'd like to just go to the acquisition strategy a little bit more, Altek seem like a nice fit, but maybe you can just give us some more color on, your thoughts on additional acquisitions, how that Altek fits into that, and what else you might be looking for?

F. Nicholas Grasberger - *Harsco Corporation - President, CEO & Director*

Well, Altek provides us access to a new industry that being the aluminum industry. That's our first step, of course. And we intend to build a platform around it to serve the aluminum industry. Of course, Altek also brings a technology that enables us to solve what is widely regarded as the largest issue that the aluminum producers and recyclers have, that is processing of or is largely due to the waste of salt cakes. So we believe that is our initial entry. There's a lot of opportunity beyond Altek within the aluminum space that we intend to pursue over time. At the same time, we're looking at a number of other adjacent markets, that all address the same theme of helping industrial companies convert their waste streams or byproducts to salable and higher value products for the downstream. So there are a number of segments we're looking at. We're very excited about the Altek acquisition, but it is just a first step. And I think you'll see us make similar moves over time whether in the aluminum space, in steel or other adjacent basic industries.

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

Okay. That's a good overview. And then on Applied Products, you talked a bit about market strength or strength and contribution there. Just wanted to clarify, is that market strength or there are other new products you've developed there and sort of what's happening in Applied Products?

F. Nicholas Grasberger - *Harsco Corporation - President, CEO & Director*

Well, it's both. I would say, the primary driver of the strength is the investment that we've made in commercial resources. So now we have dedicated Applied Product leaders and commercial resources in each of our geographic regions. So there is a big push on it. Aalso in our innovation pipeline, internally generated is a number of new product opportunities within Applied Products. So I would say, it's driven mostly by internal initiatives, but also, of course, our customers increasingly are looking for new solutions to address their waste stream within the steel industry.

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

Okay, good. And then just want to clarify, what the nickel price assumption is in the guidance at this point.

F. Nicholas Grasberger - *Harsco Corporation - President, CEO & Director*

Pete, do you have that?

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

Yes, sure, Nick. So the nickel price for the first half we assumed it was about where it is today, frankly about $6 and change per pound, the assumption is largely going to continue for the rest of the year. And as I said, that's pretty much exactly where it is today. So we don't really expect any significant change in that.

Operator

And your next question comes from the line of Jeff Hammond with KeyBanc Capital Markets.

Patricia Smart Gorman - *KeyBanc Capital Markets Inc., Research Division - Associate*

This is Trish Gorman for Jeff Hammond. Could you help us a little bit more about the updated guidance, kind of what's changing the key factors that are driving the change and maybe just clarify within Rail, it looks like the outlook for revenue, excluding SBB is slightly lower than last quarter, maybe just a little bit more color on that?

F. Nicholas Grasberger - *Harsco Corporation - President, CEO & Director*

Pete, you want to take that as well?

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

Yes. Sure. So let me start with second part of that question. I mean, the outlook for the second half for Rail is quite strong, the second half of the year tends to be strong for Rail. So certainly, as it relates to the first half, it will see significant uptick, both in terms of operating income particularly, as I mentioned in my remarks that the third quarter is where we kind of expect to be the bigger of the 2 quarters in the second half of this year, which is kind of the reverse of where it was last year. By and large, all 3 of the segments, if you look at the second half are up, and versus the prior period, and we expect the trends to continue in Industrial and Rail, particularly from what we've experienced in the first half of the year.

Patricia Smart Gorman - *KeyBanc Capital Markets Inc., Research Division - Associate*

Okay. And then, for the growth investments within M&M, kind of what impact does that have on the quarter and what should we expect going forward?

F. Nicholas Grasberger - *Harsco Corporation - President, CEO & Director*

I think that's difficult to say. I mean, clearly, the investments have been in people, and of course, the Altek acquisition. And with respect to the human resource investments, it's both the business development function, which, of course, is focused on strategy and acquisitions as well as the resources similar to the ones I mentioned for Applied Products that have been added to the business. So it's clear that we're getting a return on those investments, but I would expect the larger return to really be in 2019. As I mentioned earlier, we are expecting a nice lift in revenues and M&M in 2019, and we believe that should be around 10% revenue growth next year or a little bit higher.

Operator

(Operator Instructions) And we have a question from Fran Okoniewski with Friess Associates.

And there are no further questions.

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

Thank you, Dedra, and thank you, everyone, for joining us this morning. We certainly appreciate your interest in Harsco, and we look forward to speaking with you again in a few months. Have a great day. Thank you.

Operator

And this does conclude today's conference call. You may now disconnect. Thank you for your participation, and you may disconnect. Thank you, have a great day.