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PRESENTATION

Operator

Good morning. My name is Carmen, and I will be your conference facilitator. At this time, I would like to welcome everyone to the Harsco Corporation Second Quarter Earnings 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. Harsco Corporation will be recording this teleconference. No other recordings or redistributions of this telephone conference by any other party are permitted without the express written consent of Harsco Corporation. Your participation indicates your agreement.

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

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

Thank you, Carmen. Welcome to everyone joining us this morning, and I hope you're doing well. I'm Dave Martin, VP of Investor Relations for Harsco. With me today is Nick Grasberger, our Chairman 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 2020 and various initiatives at the company, including the integration of ESOL. We will then take your questions.

Before our presentation, however, let me mention a few items. First, our quarterly earnings release as well as a slide presentation for the 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 from those forward-looking statements. For a discussion of such risks and uncertainties, see the Risk Factors section in our most recent 10-K and 10-Q. 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 the earnings release as well as the slide presentation.

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

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

So good morning, everybody, and thanks for joining us today. While we are seeing some evidence of improvement in our end markets, the second quarter was characterized by extreme volatility and uncertainty, both for Harsco and for our customers. The volume of waste material that we processed declined about 20% year-over-year in the quarter. A bit more in our steel markets and somewhat less in most of the Clean Earth markets. Shipments in Harsco Rail held up well for most of the quarter, but began to decline later in the quarter as North American customers pushed out delivery dates due to COVID-related pressures.

Within Harsco, the pandemic and the current operating environments have brought out the best in our workforce. We've moved quickly to adapt and remain flexible, and our ability to navigate the challenges is a testament to the strength of our leadership team and the strong culture that we've built at Harsco. I truly appreciate the ongoing support that we've received from our customers, investors, relationship banks and other stakeholders. And I'd like to thank all of our employees for their resilience and dedication to our business and to our customers.

The fact that Harsco remains on track with our portfolio of transformation into a pure-play environmental solutions company, only adds to my confidence in our team and in our future.

Throughout the quarter, we were focused on 4 key priorities: first, keeping our people safe during the pandemic; also preserving liquidity; and then capturing the value of the ESOL acquisition; and fourth, executing SCOR program in Rail.

From a financial perspective, our primary focus in Q2 was to ensure a strong liquidity position and enhance our financial flexibility following the acquisition of the ESOL business early in the quarter. We made good progress with these efforts during the quarter, which encompassed cost reduction, cuts in capital spending, deferrals of certain payments, and importantly, an amendment to our credit facility. Although we expect our end markets to improve somewhat in the second half of this year, the recovery will likely be slow, and we are prepared to take further actions to strengthen our financial condition if warranted.

From a strategic perspective, we've taken several meaningful steps over the past year to transform our portfolio, as you know. At this point, it is unlikely we'll be taking any such additional steps for at least the next year, given the operating environment and our focus on the internal value creation opportunities in each of our 3 segments.

I'll take just a few minutes to comment on each of our businesses. Harsco Environmental has been the most impacted by COVID of our segments. Overall, though, I was pleased that we maintained strong margins and our ability to flex to the conditions allow the business to generate positive free cash flow during the quarter. The vast majority of steel mills that we support are now operating in contrast to the situation in early Q2. So while production levels have improved, they remain well below year ago levels. And in fact, some sites are even at historical low points. We expect only modest improvement throughout the remainder of the year.

Our focus in HE continues to be on cash flow generation and further shifting our mix and products and services towards environmental solutions to our steel and aluminum customers. Roughly 70% of our HE business today is aligned with this ambition. And recent successes derived from applied products, mobile equipment and increased collaboration with Clean Earth, support this theme and the continued shift.

Over the next few years, we certainly expect a lower degree of capital intensity in HE, as we focus more on growing the EBITDA minus capital expenditure metric than on growing revenue.

Turning to Clean Earth. We made significant progress in the quarter on the integration of ESOL. As part of that effort, our combined Clean Earth and ESOL team is working hard to improve core processes and boost customer service. As expected, this focus is yielding cost and working capital opportunities, but also better pricing discipline and execution of all the business-critical functions. We continue to identify levers to improve margins even beyond what we expected when we acquired the business. So therefore, despite the negative impact of COVID on this year's results, our EBITDA target in year 3 remains unchanged. Perhaps the most pleasant surprise has been the enthusiasm and energy of our new colleagues at ESOL. They clearly possess the passion for winning attitude, which is one of Harsco's core values. Strong leadership, active engagement and a supportive parent company has been the recipe for success in the ESOL integration to this point.

In terms of business performance, we have seen some recovery in industrial, retail and medical waste volumes. The dredge business is fairly robust, whereas the project work that feeds our contaminated soil business remains uneven and difficult to forecast in the short term.

Finally, in Harsco Rail, the execution has been remarkable given the challenges the team has faced. The core elements of our SCOR program remain on track, and the outsourcing and diversification of key supply chain components has significantly reduced the risk of delivering against our strong order backlog. On the commercial side, North American order rates are declining as expected due to capital spending cuts at the Class 1 railroads. Fortunately, our business mix is much broader than it was a few years ago, and our international projects are moving forward, largely unaffected by COVID.

I also want to highlight the most promising new product introduction we've had at Harsco Rail in decades, a next-generation tamper targeted at least initially at the North American market. The prototype has been operating for the past few months and has delivered a 50% improvement in productivity versus the industry benchmark. We look forward to completing the field testing and implementing the lessons learned in the serial version.

Our core customer base has expressed keen interest in this machine, which is the heart of the range in our product portfolio.

Before I turn the call over to Pete, I'd like to focus just a minute on our environmental, social and governance initiatives. Since ESG is tightly linked to our corporate strategy, we are placing a great deal of focus on developing a best-in-class program. In July, we released our 2019-2020 ESG report, which highlights our sustainability accomplishments over the past 18 months. One of our objectives with this year's report was to provide more metrics and data points on our ESG progress and to better align with leading sustainability reporting standards. So in addition to providing a detailed look at our vision and the transformation journey that we've been on for the past 12 months, we highlight how we are creating value for our business and positive outcomes for stakeholders across our 4 ESG focus areas. We've had a very positive response from a number of our investors and ESG ratings groups. And since January of 2019, we've seen a 40% improvement in our ESG risk rating from Sustainalytics and a 60% improvement in our environmental and social quality score from ISS.

I'll now turn the call over to Pete.

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

Thanks, Nick, and good morning, everyone. So please turn to Slide 6, and our consolidated financial summary for the second quarter. But before we go through the detail, let me echo Nick's comments. I am also pleased with our Q2 results in the context of the economic pressures we've experienced and continue to be impressed by the effort and coordination of our operational and finance teams managing through this difficult period. Our collaborative and proactive approach allowed us to react quickly to the changing market conditions. And these actions, coupled with our continued focus on safety and operational excellence, enabled us to generate strong results and positive free cash flow during the quarter.

In the second quarter, Harsco's revenues totaled $447 million and adjusted EBITDA totaled $59 million. This EBITDA figure is higher than our Q1 adjusted figure of $57 million and compares with our adjusted EBITDA of $63 million in the prior year quarter on a continuing business basis. While we didn't provide guidance for the quarter, this result was better than we had expected earlier in the quarter. Each of our businesses and various key drivers contributed to the strong quarter. We believe our efforts to control costs and the fact that underlying market conditions appear to have troughed in April and May, certainly helped.

We also benefited from the accounting for or timing of some expenditures, including employee costs. In addition, Q2 included a reduction to a compensation accrual, which will not likely recur. A good portion of these expenses are anticipated to be incurred in the second half of the year, and I'll discuss this impact further when I comment on the outlook for the third quarter.

In our Rail business, we also benefited by some aftermarket orders moving into Q2, which we had initially expected to occur in the second half of 2020. As a result, our EBITDA margin in the quarter was just over 13%, with margins in each of our legacy businesses holding up very well given the market conditions. As expected, the inclusion of ESOL diluted our consolidated margins a bit for the second quarter. The change in EBITDA compared with the prior year quarter is principally driven by lower results in Harsco Environmental due to pandemic. With this impact, partially offset by the inclusion of Clean Earth and lower corporate spending. I'll discuss these impacts further in a few minutes.

Harsco's adjusted earnings per share from continuing operations for the second quarter was $0.13 compared to $0.23 in the second quarter of last year. And please note, this figure is adjusted for integration and debt amendment costs.

Lastly and importantly, our free cash flow totaled $18 million in Q2, which is traditionally not a strong cash flow quarter for the company. By comparison, Harsco's free cash flow was negative $45 million in the second quarter of 2019. The significant improvement year-on-year is driven by lower capital expenditures and working capital. This improvement also reflects our deferral of payroll tax payments and certain pension contributions as allowed by various legislation, which totaled nearly $8 million in the quarter.

At the beginning of the year, we committed to a meaningful improvement in free cash flow compared to 2019 as well as positive free cash flow for the full year. The pandemic hasn't affected our commitment to this goal, and we expect to see more progress later in the year.

Now please turn to Slide 7, in our Environmental segment. Revenues totaled $204 million and EBITDA was $40 million. These figures translate to a margin of roughly 20%. We view this result positively given the severe economic headwinds, and we believe it reflects our ability to flex our variable and semi-fixed costs in recent months. Compared to the same period last year, revenues and profitability were as expected, impacted mainly by lower services and products demand as a result of the pandemic and foreign exchange translation. Revenues decreased 24% year-on-year or 19%, excluding the impact of foreign exchange.

Steel output at our customer sites declined approximately 23% on a continuing site basis compared with the prior year quarter. Importantly, the utilization rate at our customer sites for the quarter dropped below 62%, making this the lowest operating rate for our customers since 2009. As I mentioned earlier, these negative factors were partially offset by lower operating and administrative expenses. Harsco Environmental's free cash flow totaled $22 million in the quarter, and now totals $32 million for the year. This year-to-date figure compares with negative free cash flow of $16 million in the prior year. Overall, I believe these results are positive and illustrate the process and structural changes we've made in this business in recent years.

Next, please turn to Slide 8 to discuss our Clean Earth segment, which now includes the ESOL business that we acquired in early April. For the quarter, revenues were $162 million and EBITDA totaled $11 million. While not apparent on the slide, revenues were down approximately 20% for the second quarter compared with the prior year quarter on an apples-to-apples basis with similar comparisons for both the legacy Clean Earth business and ESOL. The financial impacts of ESOL are included in the hazardous waste details on the slide. Among our business lines, the hazardous and dredge materials volumes held up better than contaminated materials, where the stoppage of construction projects in states like New York and Pennsylvania impacted results.

Lastly, Clean Earth's free cash flow totaled $6 million in the quarter and now stands at $21 million year-to-date.

Let me also comment on the ESOL integration, which, as Nick mentioned, is going well despite the COVID headwinds. We are well on our way to executing the actions necessary to double the EBITDA in 3 years, meaningfully increase cash flow generation and efficiencies and improve the overall customer experience. In addition to an intense focus on the inquiry to order and order to cash processes, which will provide EBITDA generation and significant cash flow improvement, we are also looking at key operational improvement initiatives, inbound and outbound logistics optimization, procurement and commercial improvements as well. We expect to realize more than $5 million of benefits this calendar year with annual run rate benefits of $30 million to $35 million by the end of year 2.

Now please turn to Slide 9 in our Rail business. Rail revenues were $82 million or similar to Q2 2019 levels, while the segment's adjusted EBITDA declined to $10 million from $12 million in the previous year quarter. The changes can be attributed to a less favorable mix across all product lines and lower short-cycle volumes. The impacts within our equipment and technology businesses can be attributed to lower sales to our Class 1 and metro customers within North America. Some of this change was anticipated given the timing of shipments, but some is likely driven by discretionary spending cuts by our customers, which are continuing to face economic pressures from the pandemic as well. These negative factors were partially offset by additional contracting work in the U.S. and U.K. as well as manufacturing efficiencies and lower SG&A costs.

Rail's backlog continued to show positive trends in the quarter, totaling $456 million at the end of the quarter. This figure is up 57% year-on-year and 5% quarter-on-quarter. Despite the pandemic, our bookings were strong in the quarter. This order activity was also broad-based, while we likely benefited from the timing of some of these orders. Our key wins included additional equipment orders from India and Hungary, aftermarket sales into China and standard equipment sales in the U.S.

Lastly, on the SCOR program in Rail, as Nick mentioned, we continue to make very good progress and are tracking on target with key initiatives, including capacity, competency and quality. We've achieved roughly 75% of year-end objectives. And given our record backlog, achieving these milestones will allow us to continue growing this business.

So before I conclude, let me comment on our balance sheet and the outlook, starting with our financial position. We ended the quarter with net debt of $1.2 billion and a leverage ratio of 3.9x. Also, our liquidity was approximately $390 million at quarter end. Maintaining financial flexibility is very important to us, and we took actions this quarter in that regard. As previously announced, we took advantage of favorable market conditions and excellent relationships with our key banks to amend our covenants and provide us even more liquidity. This was a proactive decision, not driven by business performance or a change in our market outlook. Rather, I view this move as more of an insurance policy, a prudent action given that economic conditions remain fragile and our visibility is limited. Under the revised covenants, our debt to adjusted EBITDA covenant steps up to 5.75x, starting in Q3, and our liquidity position will strengthen as a result.

Looking further forward, as we stated in the past, reducing our debt is a top priority for Harsco. And our goal is to see our leverage ratio below 2.5x within a couple of years. And while we are well above this target currently, I'm very comfortable with our current financial position and our ability to manage through the current economic conditions.

Lastly, let me turn to the outlook. Future economic trends continue to be uncertain and likely to remain volatile given the effects of the pandemic. Accordingly, we will again refrain from providing detailed guidance. With that said, however, I can provide some directional guidance for Q3 given where we stand in the quarter and certain other factors, including the timing of expenditures in Q2 and Q3.

First, it seems that business activity appears to have touched bottom in Q2. Specifically, this likely occurred for Harsco Environmental in April and Clean Earth in May. We've seen stability and some improvement since then in these businesses. However, this improvement is uneven and slow and, in some cases, slower than we previously hoped. For Clean Earth, demand from the retail market, which had some spots of strength throughout the pandemic, appears to have come back, particularly the large retailers. Our daily activity, which had dropped off in Q2, is now only modestly below pre-COVID levels, and this volume is being helped by a backlog of material as the economy reopened. Elsewhere within Clean Earth, including within the industrial and nonhazardous markets, activity is less robust and more mixed.

Additionally, as you know, some states are now slowing reopenings, while others are putting restrictions back in place. And this dynamic likely impacts most within the Clean Earth segments.

In Harsco Environmental, roughly 40 of our customer sites were shut down at one point in April. Today, thankfully, that number is only a few. However, operating rates or production levels at customer locations remain subdued, as you would imagine, given trends in the relevant end markets.

In Rail, the pandemic impact is less visible from the outside. However, as we start to see in June, our freight and metro customers in North America begin to curtail capital and operating spend. Some orders that we had anticipated, which are not in backlog, have now been deferred. We are hopeful that we will offset this pressure with incremental offshore sales and cost actions, but this domestic trend further reduces our visibility.

So all this means for Harsco is that we anticipate a modest increase in revenues in the third quarter relative to the just completed second quarter. Although this increase is anticipated to be more pronounced for Clean Earth and for Rail. Despite this revenue trend, we anticipate that our adjusted EBITDA will be consistent with or declined slightly versus Q2. The timing of certain expenditures, which includes some insurance costs, professional fees and variable compensation expenses, together with the accrual adjustment mentioned earlier, is expected to offset the benefit of higher revenues. And relative to the second quarter, these expense items will likely impact the comparison by as much as $10 million to $12 million in the third quarter.

Let me close that by -- in saying that all things considered, I'm pleased with our Q2 results. And I'm confident in our balance sheet and our ability to withstand the current economic pressure, thanks to our ongoing efforts to control costs, limit capital spending and maximize free cash flow. Our cost reduction objective is now $20 million for the year, and we continue to target positive cash flow for the full year.

So that concludes our prepared remarks, and I'll turn the call back to the operator to open the line up for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We'll go ahead with your first question, that will come from Michael Hoffman with Stifel.

Michael Edward Hoffman - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Group Head of Diversified Industrials Research*

So I appreciate not giving guidance in light of this just moving pieces. But how do you feel about a backstop around free cash flow since you've alluded it will be positive? You've managed to get leverage below 4x. Can you help us a little bit about what the backstop might be on free cash flow, nothing less than kind of number as opposed to a guidance range?

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

Michael, it's Pete. Right now, I think it's -- we feel very comfortable saying it's going to be positive free cash flow. I think given the volatility and the uncertainty in the markets as well as the timing of some of the payments that come from our customers in any period of time, I think it's best that we just leave it at that rather than put any sort of backstop, as you said.

Michael Edward Hoffman - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Group Head of Diversified Industrials Research*

Okay. Can I ask it a different way. Will you -- do you think it'll be free cash flow positive in the second half since you were in the first half?

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

Yes, I think so. That's the plan.

Michael Edward Hoffman - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Group Head of Diversified Industrials Research*

Okay. So I could assume that I will be better than the first half, is at least a minimum?

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

Yes, that's a good way to look at it, Michael.

Michael Edward Hoffman - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Group Head of Diversified Industrials Research*

Okay. All right. That helps a lot. And then the -- within the context of the Clean Earth business, when you say industrial is lumpy, is it big generator, small generator? Is there an end market that you're seeing that clean harvest has just reported, and they are alluding to that there's some softness in chemical, for instance, but they've reinstated in revised guidance? So I'm just curious what you're thinking and seeing on your industrial business?

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

Yes. Well, first of all, Michael, it's Nick. The lumpiness in Clean Earth is really predominantly in the soil business. I think the industrial business has stabilized and is moving north a bit. So I would characterize it as a bit more stable and predictable. It's going to be -- these large construction projects that feed our soil business that are lumpy.

Michael Edward Hoffman - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Group Head of Diversified Industrials Research*

Yes. And that's consistent with what you're hearing from ABI and some of that sort of indexing around future non-res construction. The last question then for me. You did a terrific job of proving that you can, in fact, flex costs around the steel business. If activity stays right where it is right now, at one point, you thought steel would be down about 15%, overall worldwide production. Where is your view about steel in context of those comments back in June?

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

Michael, it's Pete. It's virtually the same. Right now, our expectation is that overall steel production, at least as it relates to our customers, will be down about anywhere from 13% to 15% for the full year.

Operator

Your next question will be from the line of Jeff Hammond with KeyBanc Capital Markets.

Jeffrey David Hammond - *KeyBanc Capital Markets Inc., Research Division - MD & Equity Research Analyst*

So just on Rail. Can you just talk about the cadence into the second half given the kind of balance of very strong backlog versus some of these deferrals that you're seeing? And how does that kind of inform that 12% to 14% EBITDA margin you talked about last quarter?

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

Yes. Well, first of all, we certainly expect that the second half in Rail to be a good bit better than the first half. We're also still looking at good double-digit EBITDA growth year-over-year in the Rail business. From a margin standpoint, the margin should lift as well. So Q3 margins will likely be similar to that in Q2, but Q4 should be better.

Jeffrey David Hammond - *KeyBanc Capital Markets Inc., Research Division - MD & Equity Research Analyst*

Okay. So the deferrals are more impacting new orders coming in and the second half getting materially better?

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

Yes. I think the North American business will be softer in the second half than what we had thought 3 months ago. Some of the pushouts are within the year, some of them are into '21.

Jeffrey David Hammond - *KeyBanc Capital Markets Inc., Research Division - MD & Equity Research Analyst*

Okay. And then certainly some noise with the ESOL acquisition coming in. It looks like the soil business is kind of the big headwind in the bridge. But can you just talk about how the hazardous business performed versus your expectation in the quarter, both in terms of top and bottom line?

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

Yes. Yes. I would say, generally speaking, that the volume trends that we saw in hazardous, while consistent with the market, were nonetheless a bit weaker than we thought they would be. A good bit of that was retail. As I mentioned, that's coming back. Some of that was medical. That's coming back as well. And of course, the industrial volumes with production picking up are also improving. But I would say, in general, they were softer than we anticipated. But again, as we look at the performance of kind of peer companies in the hazardous sector, we believe our trends have been consistent with theirs.

Jeffrey David Hammond - *KeyBanc Capital Markets Inc., Research Division - MD & Equity Research Analyst*

Okay. And then construction materials, a lot of my companies that sell into non-res are seeing work stoppages abate and things improve. And if -- are you starting to see some of that loosen up and some of these work stoppages abate where that business would get better?

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

Yes, we have. But I think, on the other hand, we've still been surprised particularly in the Northeast, that other projects that we expected to restart have not yet restarted. So it's -- it has been a bit of a surprise for us. But that business changes week-to-week, day-by-day in this environment. So it's difficult to project, as I mentioned.

Jeffrey David Hammond - *KeyBanc Capital Markets Inc., Research Division - MD & Equity Research Analyst*

Okay. And then the higher cost, was the number you said, the $10 million to $12 million sequentially, is that mostly in corporate? Or does that kind of blend across the segments?

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

Yes. That's across the segments. There's an element in the corporate cost, Jeff, but it's pretty much almost proportionate across the business units.

Jeffrey David Hammond - *KeyBanc Capital Markets Inc., Research Division - MD & Equity Research Analyst*

Okay. And then just final question. On the ESG, good to see your sustainability report and improvements. Can you just talk about, as you get feedback from some of these ESG funds and the people that look at it, in your self assessment, like where are the biggest opportunities for you guys to continue to kind of improve on the curve?

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

Yes. Well, I think a lot of it, honestly, is driven by better disclosure of the things that we are doing, and we have done. A lot of the metrics that others look at, we historically had not provided and had not disclosed. We're beginning to do that. So that's helpful. Clearly, on the social and the governance side, I think we have been and we continue to get stronger. I think the focus is really more on the E, the Environmental. And again, a lot of it comes down to better tracking and focus on certain metrics. And we've made good progress there. There's an awful lot of focus on it now. And of course, with the shift in our portfolio, we'll have even better metrics and results. So that's really the focus.

Operator

Your next question is from the line of Rob Brown with Lake Street Capital.

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

Just following up again on the Rail pushouts in terms of potential new orders. How -- I know the visibility isn't great. But how quickly can that come back? What's sort of the dependency there? And maybe historically, what have you seen in terms of that order activity kind of resuming?

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

I think generally what we've seen is that the Class 1s tend to be a little bit slow to reduce their capital spending budgets, and we certainly saw that over the last quarter. But at the same time, they're then reluctant to boost it back up. So they -- it tends to lag a bit. And so I think it's unlikely that the recently announced capital spending reductions by the Class 1s will be reinstated this year.

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

Rob, this is Pete. Let me just add just one other point. When we're talking about these pushouts, these are all relative to our previous expectations for the second half. I think the main point is that we do anticipate there's still to be meaningful growth in this business even in consideration of those pushouts compared to prior year.

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

Yes. Okay. Great. That's great color. And then the Clean Earth activity, you mentioned a number of things you were doing and starting to work on. But does this COVID slowdown really change anything in terms of what you're doing in terms of getting Clean Earth and ESOL integrated? Or is that really progressing on plan? And do you -- are you seeing any new opportunities kind of develop as you get into it?

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

Yes. Yes. Yes, good question. No, I don't see any impact of COVID on our ability to integrate the business and to capture the benefits that we identified, as I highlighted earlier. We've been very happy as we've dug into the business and reached out to our new colleagues at ESOL and solicited their thoughts, and very pleased with the additional opportunities that we've identified. So I think despite the pandemic situation, the upside in the business is even greater than we thought.

Operator

(Operator Instructions) Your next question will come from the line of Larry Solow with CJS Securities.

Lawrence Scott Solow - *CJS Securities, Inc. - Senior Research Analyst*

Just on the Rail segment, again, I just missed the beginning. So on the pushout, is that more North America related or is that across the board? And obviously, most of your growth has been coming internationally. So I was just trying to assess that.

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

Yes. Yes. No, it's really all in North America. Of course, our customer base in North America is largely private. Our customer base outside the U.S. is largely funded by governments, right, infrastructure projects and so forth. And so the international business has been largely unaffected by COVID, and those projects are continuing on the time line that we had expected months ago.

Lawrence Scott Solow - *CJS Securities, Inc. - Senior Research Analyst*

And mostly your growth in backlog and your expectations moving out have been more on the international side. Is that correct or...

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

Yes, absolutely. So the big wins that we've had with the Deutsche Bahn, Pete mentioned in this past quarter, India and Hungary. Yes.

Lawrence Scott Solow - *CJS Securities, Inc. - Senior Research Analyst*

And you still expect -- I know you're not giving guidance, but you still expect sequential improvement in both margin and sales as we go into the back half in Rail, correct?

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

We do. Yes.

Lawrence Scott Solow - *CJS Securities, Inc. - Senior Research Analyst*

Okay. And then in terms of -- you mentioned international really haven't seen any pushouts. But just on a longer-term basis or a mid- to long-term basis, any fear anecdotally that -- obviously, you have a great backlog and you can probably live off that for some time. But I know you have expectations of inevitably maybe 3, 4 years out reaching a $500 million segment sales number and $100 million EBITDA number. Is that still within your sort of longer-term targets?

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

Yes, very much so. I think the international opportunities continue to expand, as I mentioned before. I think the success technologically in our SBB contract has really boosted our brand. Many doors have been opened. We will have a good look at similar opportunities in the EU and also in Southeast Asia. So I think I've never been more optimistic about the international portion of the Rail business.

Lawrence Scott Solow - *CJS Securities, Inc. - Senior Research Analyst*

Got it. And then just switching gears real fast. On the Environmental, obviously, unprecedented period, you're reducing growth CapEx, which completely makes sense. How about -- as the markets start to recover, do you guys -- I'm sure you will return to some growth capital expectation, but do you -- is that somewhat tempered longer-term with sort of a greater focus on cash flow?

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

Yes. Good question. And absolutely, it is tempered. We're focused more on shifting the mix within the business than unnecessarily growing the top line. So I think you'll see EBITDA minus capital spending continuing to grow, whereas revenue will be a bit more muted. And it's all focused on shifting that mix to less capital intensive, more environmentally-oriented services and products.

Operator

Next question comes from the line of Chris Howe with Barrington Research.

Huang Howe - *Barrington Research Associates, Inc., Research Division - Senior Investment Analyst & Research Analyst*

I just wanted to follow up on some of those questions that we've had on the Rail segment. You commented about the backlog having a higher mix in the International business. But perhaps you can dig in a little bit further as to how the aftermarket piece is doing. I know you said the short-cycle business, there was some pull forward in this quarter. What are your expectations for that piece of the business as we look forward? And I know the backlog -- in terms of the backlog, perhaps you can comment on the adjusted EBITDA to free cash flow conversion in this segment and kind of what your expectations are for cash flow generation here?

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

I'll take the first part of that, Chris. Yes, I think the aftermarket business outside the U.S., let's say, primarily in China should remain strong in the second half of the year. One thing we -- you need to consider is that, as this backlog internationally is delivered and most of that, of course, is equipment, okay, which will have bit of a dampening effect overall on margins. As we -- as that installed base over time requires aftermarket components, that's where we'll see the real margin lift. So aftermarket outside North America today is, in terms of margin, predominantly in China. But that's going to shift over time. We'll still have good margin in China. But you'll start to see more aftermarket following our new installed base in Europe.

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

Yes. Let me just add a couple of other points. So with respect to aftermarket, so for the reasons Nick just mentioned, the percentage of aftermarket as a total of the whole business units, revenues for example, will be smaller than it had been in the prior year just because of the increase in new equipment orders and deliveries. In terms of free cash flow, as we're growing, you appreciate that the cash flow for this business is modest as we grow. And that's because we start making investments as we build the inventory for these long-term contracts and don't deliver the cash flow until we actually get the units delivered. So the expectations of cash flow generation for this business unit are very, very modest this year. And they will increase in subsequent years as we start delivering the units and start to take advantage of the aftermarket on that installed base.

Huang Howe - *Barrington Research Associates, Inc., Research Division - Senior Investment Analyst & Research Analyst*

Okay. And then my last question is in regard to ESOL. You mentioned the reaffirmation of your goal to get to that $70 million, and the cost savings and synergies are still there and will be realized as time moves forward. But from a -- as we kind of look over the integration, can you maybe talk about what's moving slightly ahead of expectations? What's been discovered that previously was undiscovered? And kind of how things are moving along from an innings perspective?

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

Yes. Yes. Yes, I would say, as we understand the business better and the industry better, we've realized in terms of, let's say, the value proposition that we believe, the Clean Earth segment can provide to the market, there's an opportunity there to differentiate somewhat from the existing market participants. So it's something we're very focused on now. It's not just about the integration, although, of course, an awful lot of work is being done there. We're also very focused on that value proposition. And we think that there's a lot of upside in the business over time as we carve out a somewhat unique position in the market around customer service. So that's been, I think, longer term, one of the more appealing aspects of the acquisitions that we've made in the Clean Earth segment.

Operator

We have no other questions at this time. I will now turn the call back over to Dave Martin for any closing remarks.

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

Thank you, Carmen, and thank you, everyone, for joining us this morning. Please contact me with any follow-up questions. And again, we appreciate your interest in Harsco and look forward to speaking with you in the future. Take care.

Operator

Thank you. Thank you again for joining today's conference. This concludes the call. You may now disconnect.
