

Harsco's Affirms Harsco's IDR at 'BBB-'; Outlook Negative

Written by Australian Business

CHICAGO--([BUSINESS WIRE](#))--Fitch has affirmed the long-term Issuer Default Ratings for Harsco Corporation (Harsco) (NYSE: HSC) at 'BBB-' following the company's announcement that it will sell its Infrastructure segment. The Rating Outlook is Negative.

Harsco will sell the Infrastructure business to a joint venture (JV) with Clayton, Dubilier & Rice (CD&R). The transaction will combine Harsco's Infrastructure business with Brand Energy & Infrastructure Services, Inc., which CC&R is simultaneously acquiring from First Reserve. In return, Harsco will receive \$300 million cash and retain a 29% equity stake in the JV.

The newly formed JV, Brand Energy & Infrastructure Services, will be capitalized with \$1.7 billion of new debt, for which Harsco will not be a guarantor. The transaction is expected to close by the end of calendar 2013, subject to customary closing conditions and regulatory approvals.

The ratings and Outlook continue to reflect Fitch's expectation for the continuation of negative revenue growth, pro forma for the transaction, over at least the near term. The Metals & Mining segment, which represents roughly two-thirds of pro forma Harsco, is operating amid low steel production levels and Harsco's exit from unprofitable contracts.

Sales in the company's Rail segment, which represents about 15% of pro forma sales, are declining from the wind down of a large multi-year contract with the Chinese government. Profitability will be pressured over the near term, given the higher profit profile of this five-year contract.

The Industrial segment (20% of sales) is expected to be flat due to stable demand, as a challenging developed market environment is being offset by increasing penetration in international markets.

Nonetheless, the transaction should strengthen Harsco's credit profile over the longer term by carving out a business that would have likely remained a drag on consolidated operating results. The \$300 million cash payment augments liquidity and supports

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investment and bolt-on acquisitions within the context of a still weak operating environment.

The sale will strengthen operating profit and margin, given Infrastructure has represented more than 30% of consolidated sales and operated at a loss for 14 consecutive quarters. Fitch estimates operating income margin will approach 10%, pro forma for the sale, versus just below 6% on a consolidated basis for the latest 12 months (LTM) ended June 30, 2013.

Profitability also will strengthen upon the full realization of costs savings related to restructuring, which Harsco expects in 2013. Harsco estimates completed restructuring will yield \$95 million in total savings in 2013 (a portion of which is related to Infrastructure) after achieving \$86 million in 2012, resulting in operating leverage when revenue growth resumes.

The transaction will modestly strengthen annual free cash flow (FCF), albeit from negative levels in each of the last two years. FCF growth could be offset by incremental investments in growth initiatives. Also, the sale's terms require Harsco to make annual cash or 'in-kind' payments approximating \$15 million after-tax to CD&R, over at least the intermediate term.

Credit protection measures should strengthen slightly, pro forma for the transaction. Pro forma for the transaction, Fitch estimates total debt to operating EBITDA was approximately 2.5 times (x) as of June 30, 2013. Fitch forecasts that total leverage will remain in the 2.0x-2.5x range.

Fitch's expectations for modest FCF incorporates cash payments related to prior restructuring programs, a slight uptick in capital spending, driven by M&M's shift in focus to higher margin resource recovery and environmental services, and \$34.1 million of cash pension contributions.

Harsco's net pension obligations increased to \$384 million at the end of 2012, up from \$344 million at the end of 2011, mostly from lower discount rates. Qualified and non-qualified U.S. plans were 69% funded at the end of 2012, while international plans

were 73% funded.

KEY RATINGS DRIVERS

Rating concerns include: i) top line growth challenges within context of excess global steel capacity, exiting unprofitable contracts in M&M and uneven rail project spending; ii) low operating margins through the cycle, which should strengthen pro forma for the sale, and ii) meaningful customer concentration in M&M. Strengths include: i) strengthened liquidity; ii) leading positions in a diversified set of end markets; and iii) commitment to conservative financial policies and cash deployment through restructuring phase.

RATINGS SENSITIVITIES

Fitch could stabilize the ratings with expectations for the resumption of revenue growth and positive FCF, driven by Harsco appropriately scaling its cost structures.

Negative rating actions could occur from: i) the continuation of negative annual FCF, from more significant than expected revenue declines or inability to realize the full benefits of current restructuring programs, or ii) slow international markets penetration in conjunction with structural demand weakness in developed markets.

Harsco's liquidity at June 30, 2013 was adequate and included: i) \$89 million of cash and cash equivalents, and ii) \$372 million of availability under a \$525 million revolving bank credit facility (RCF) expiring in 2017.

Fitch believes availability under the RCF have been reduced by Harsco's use of the RCF to refinance \$150 million of senior notes that matured on Sept. 16, 2013. Harsco may use proceeds from the Infrastructure sale to repay borrowings under the RCF.

Expectations for modest annual FCF also should support liquidity. Cash deployment for

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acquisitions could accelerate following the sale but Fitch continues to believe share repurchases will be minimal while Harsco focuses on organic growth.

Pro forma for refinancing the \$150 million senior notes maturity on Sept. 15, 2013, total debt at June 30, 2013 included:

--Borrowings under the RCF;

--\$250 million of senior notes maturing in 2015;

--\$450 million of senior notes due 2018.

Harsco's recent RCF amendment replaced the debt to capitalization financial covenant of not more than 60% to a total debt to EBITDA covenant of not more than 3.5x.

Fitch has affirmed the following ratings for Harsco:

Harsco Corporation

--IDR at 'BBB-';

--Senior unsecured credit facilities at 'BBB-';

--Senior unsecured debt at 'BBB-'.

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The short-term IDR and commercial paper (CP) rating of 'F3' have been withdrawn.

Additional information is available at 'www.fitchratings.com'.

Applicable Criteria and Related Research:

--'Corporate Rating Methodology' (Aug. 8, 2012).

Applicable Criteria and Related Research:

Corporate Rating Methodology: Including Short-Term Ratings and Parent and Subsidiary Linkage

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=715139

Additional Disclosure

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