



Federal Signal Corporation
First Quarter Earnings Conference Call
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C O R P O R A T E P A R T I C I P A N T S

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Jennifer Sherman, *President, Chief Executive Officer*

C O N F E R E N C E C A L L P A R T I C I P A N T S

Walter Liptak, *Seaport Global*

Chris Moore, *CJS Securities*

Ken Newman, *KeyBanc Capital Markets*

Marco Rodriguez, *Stonegate Capital Markets*

Steve Barger, *KeyBanc Capital Markets*

Greg Burns, *Sidoti & Company*

P R E S E N T A T I O N

Operator

Greetings, and welcome to the Federal Signal Corp. First Quarter 2020 Earnings Conference Call.

At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. If anyone should require Operator assistance during the conference, please press star, zero on your telephone keypad. As a reminder, this conference is being recorded.

I would now like to turn the conference over to your host, Mr. Ian Hudson, Chief Financial Officer, please proceed, sir.

Ian Hudson

Good morning, and welcome to Federal Signals First Quarter 2020 Conference Call.

I'm Ian Hudson, the Company's Chief Financial Officer. Also with me on the call today is Jennifer Sherman, our President and Chief Executive Officer.

We refer to some presentation slides today, as well as to the earnings news release which we issued this morning. The slides can be followed online by going to our website: federalsignal.com, clicking on the investor call icon and signing into the webcast. We have also posted the slide presentation and the earnings release under the investor tab on our website.

Before I turn the call over to Jennifer, I'd like to remind you that some of our comments made today may contain forward-looking statements that are subject to the Safe Harbor language found in today's news release and in Federal Signal's filings with the Securities and Exchange Commission. These documents are available on our website. Our presentation also contains some measures that are not in accordance with U.S. generally accepted accounting principles. In our earnings release and filings we reconcile these non-GAAP measures to GAAP measures. In addition, we will file our Form 10-Q later today.

Jennifer is going to kick things off today with some introductory comments. I will then give some more details on our first quarter financial results before turning the call back to Jennifer to discuss the impact of the coronavirus pandemic on current operations and its effect on our outlook for the rest of the year. After that, we will open the line for any questions.

With that, I would now like to turn the call over to Jennifer.

Jennifer Sherman

Thank you, Ian.

These are not normal times and I'm going to start this call in a non-traditional manner, with the conclusion. The conclusion is, Federal Signal is well positioned to weather the storm, and we will continue to grow and thrive in the long run.

Our portfolio of businesses includes many market leading brands with solid fundamentals. We have a strong financial position, a history of robust cash flow generation, a culture of winning, a clearly defined strategy, and an experienced team with a proven track record of anticipating issues and proactively implementing responses. The coronavirus has not changed any of these factors.

We had a great first quarter. We expect the second quarter will be tough, and at this time, the rest of the year remains uncertain. We have record backlogs that will allow us to both adjust and optimize our production schedules to serve our customers. We have also created several new offensive strategies with our Reclaiming Tomorrow, Together initiative that will create opportunities for new products and potential for acquisitions. We have outstanding people, ample liquidity, quality businesses, and we have acted swiftly and decisively to keep our employees safe.

I'd like to start by giving my profound thanks to each of our employees for their commitment over the past several weeks. The coronavirus pandemic has impacted almost every aspect of our daily lives. One of the stark realities of this pandemic is that virtually all participants in our highly integrated economy, including our employees, our customers, our dealers, our suppliers, and our investors are facing economic challenges and personal uncertainties that are not of their own making, and over which they have limited control. Despite these unprecedented challenges, I've been so proud of the positive attitude and adaptability that I've seen from our employees.

As a company, our mission statement has never been more relevant. Our products move material, clean infrastructure, and protect the communities where we work and live. Our businesses are considered to be essential in supporting critical infrastructure needs and public safety. During this global pandemic, the prospect of clogged sewer lines potentially containing the virus that causes COVID-19 or worse, a backup and sewage waste into our environment is something we need to avoid. The various stay at home orders issued around the country are placing dramatically higher demand on community wastewater, sewer, and storm water systems, and we play an essential role in providing parts service and equipment to support our municipalities, governments and utilities in their efforts.

Cleaning, the central function of many of our products has never been more essential. We also provide first responders with critical equipment and outfitting services, both domestically and throughout the world. While certain of our operations have been affected by temporary facility closures, either due to government issue mandates, or other COVID-19 related issues, our facilities have so far remained substantially operational during the pandemic. The outstanding results that we were able to deliver in exceptionally difficult circumstances during the first quarter were a testament to the quality of our businesses, the commitment of our employees and the agility of our teams. On a consolidated basis, our net sales were up 4% compared to last year, and our operating income improved by 25%. Our Adjusted EBITDA margin for the first quarter was 15.3% towards the higher end of our target range and up 220 basis points from last year.

We also reported a 2% improvement in orders, contributing to a record backlog at the end of the quarter. Our first quarter performance was even more notable, given that we started to see some of the negative impacts from the coronavirus pandemic in mid-March.

Since the outbreak of the pandemic, a critical area of focus has been the health and safety of our employees and I'd like to take a minute to talk about some of the things that we've been doing with that in mind.

Towards the end of February when the first cases were reported in the U.S, we began proactively securing cleaning supplies and developing plans to protect the safety and well being of employees at each of our facilities. We also formed an internal COVID task force led by our Chief Operating Officer Mark Weber and established centralized protocols for addressing coronavirus related issues.

We were proactive and implementing enhanced health and safety measures across the organization, establishing remote working arrangements where possible and increasing the frequency of communications to reinforce health and safety guidelines. We have a daily 5 o'clock pulse call with our executive leadership team to discuss ongoing developments and share best practices on how we can continuously improve our supportive employees, suppliers, dealers and customers during this pandemic. We end each trial with one team member presenting their positive thoughts for the day. Candidly, some days have been easier than others. Honest, accurate and frequent communication is one of the guiding principles we continue to operate under. We have implemented many new business practices, including split shifts at certain locations, providing protective masks for our employees and modifying our production processes in ways that allow us to adhere to social distancing guidelines. We put controls in place to limit the number of visitors to our facilities, and consequently, we put our Vactor expansion project on hold in March. With additional measures in place, we have recently restarted some of the construction at Vactor on a reduced schedule. But, the completion of this project is expected to be delayed another quarter.

We've also modified our employee attendance policies and provided employees with additional paid time off in order to encourage those who were sick, had health concerns or who were otherwise adversely impacted by the pandemic to remain at home. While we recognize that there's an element of good fortune, we strongly believe that the actions we have taken have helped protect our workforce, with only a handful of employees having contracted the virus. Thankfully, all those individuals have since recovered, and currently no one is hospitalized. To me, this is the most important fact that I will share on this call today. Going forward, the health and safety of our employees will remain a key priority of our teams.

It is also extremely important to all of us at Federal Signal that we do our part in the communities in which we work and live to assist in the overall COVID response efforts. In these uncertain times, protecting the safety and well-being of the public seems more important than ever. On that note, we recently launched a website dedicated to cleaning and sanitizing efforts in response to the coronavirus outbreak. In launching this website, we're reminding new and existing customers, dealers and end users that the installed base

of products manufactured by our environmental solutions group can be used in efforts to clean and sanitize outdoor public areas, such as recreational spaces, parks, and museums. In addition, these products can be used to sanitize other vehicles like buses or rail cars, as well as cleaning bridges, train stations, and any other outdoor areas. We have already seen our equipment used in ways that we had not imagined before the outbreak of the pandemic. For example, our sewer cleaners are now being modified to use heating and disinfecting solutions to sanitize shopping carts at grocery stores, and to clean outdoor areas that homeless people frequent in Los Angeles.

Talented team members at our University Park facility also pivoted quickly to design and manufacture protective face shields for our first responder customers and our own employees to use. This team has ramped up production to build approximately 800 units per day. The first shipment recently delivered to the city of Chicago Police Department, followed by deliveries to each of our manufacturing facilities for our employees to use. We expect to assemble approximately 5,000 units initially with the ability to increase that as needed. As many of you know, demand for food assistance is unfortunately rising at an extraordinary rate. The combination of need, scarcity and anxiety surrounding food is unprecedented. Due to this increase in demand, a \$1.4 billion shortfall is predicted in the next six months alone. Help is greatly needed. At Federal Signal, we are doing our part by supporting local food banks. We're also identifying other ways in which we can support those in need.

I'm extremely proud of the part that we are playing and responding to this pandemic.

I'll now turn the call back over to Ian to go over the numbers.

Ian Hudson

Thank you, Jennifer.

Our consolidated first quarter financial results are provided in today's earnings release. In summary, we got off to a strong start to the year and the team did an excellent job navigating through a variety of unprecedented challenges, which became more impactful towards the end of the quarter. Our first quarter results reflect impressive increases in sales and income, a 220-basis point expansion in Adjusted EBITDA margin and a 30% improvement in adjusted earnings per share. Consolidated net sales for the quarter were \$286 million, up \$12 million or 4% compared to last year. Consolidated operating income in Q1 this year was \$32.3 million, up \$6.5 million, or 25% from last year. On an adjusted basis, consolidated operating margin was 11.6%, up from 9.7% in Q1 last year. Consolidated Adjusted EBITDA for the quarter was \$43.9 million, up \$8 million, or 22% from Q1 last year. That translates to a margin of 15.3% in Q1 this year, up from 13.1% last year.

Net income in Q1 this year was \$23.4 million, compared to \$17.5 million last year. That equates the GAAP EPS of \$0.38 per share, up from \$0.29 a share last year. On an adjusted basis, EPS for Q1 this year was \$0.39 a share, which compares to \$0.30 per share last year.

Water intake in the first quarter continue to be strong with orders of \$304 million, up \$5 million, or 2% compared to last year. Consolidated backlog at the end of the quarter again set a new Company record at \$401 million. That represents an increase of \$37 million, or 10% compared to last year, and an increase of \$14 million or 4% from the end of December. In terms of our first quarter group results, ESG's first quarter sales were \$233 million, up \$14 million, or 6% compared to last year. ESG's operating income for the quarter was \$29.4 million, up \$3.7 million, or 14% from Q1 last year. ESG's Adjusted EBITDA for the quarter was \$14 million, an improvement of \$5.3 million or 15% from a year ago. That translates to an Adjusted EBITDA margin of 17.2% in Q1 this year, which is up 140 basis points compared to 15.8% last year. ESG reported total orders of \$238 million in Q1 this year, down 3% from last year.

SSG sales in Q1 this year were \$53 million compared to \$54 million last year. The slight decrease in sales was primarily due to lower sales of public safety products in Europe, where our business in Barcelona Spain started to be impacted by the coronavirus outbreak earlier than some of our U.S. based businesses.

SSG's operating income for the quarter was \$7.4 million, compared to \$8.7 million in Q1 last year. Adjusted EBITDA for the quarter was \$8.2 million compared to \$9.6 million a year ago, and SSG's Adjusted EBITDA margin in Q1 this year was 15.4% compared to 17.7% last year. SSG's orders in Q1 this year were strong at \$66 million, an increase of \$11 million, or 20% from last year. The improvement was largely due to higher global orders for public safety equipment.

Corporate operating expenses in Q1 this year were \$4.5 million, down from \$8.6 million last year, with approximately \$2.6 million of the year-over-year decrease, resulting from changes in fair value adjustments to certain reserves. These market-based adjustments benefits of their earnings in Q1 this year by approximately \$0.02 per share but were unfavorable in Q1 last year. Corporate expenses in Q1 this year also include lower expenses associated with stock and incentive-based compensation.

Turning now to the consolidated income statement where the increase in sales contributed to a \$4.5 million improvement in gross profit. Consolidated gross margin improved to 26.1% for the quarter, up from 25.7% last year. As a percentage of sales, our selling, engineering, general, and administrative expenses for the quarter were down 120 basis points from Q1 last year. Other items affecting the quarterly results include a \$300,000 decrease in acquisition related expenses, a \$200,000 reduction in other expense and a \$500,000 decrease in interest expense associated with lower average debt levels and interest rates in comparison to the prior quarter.

Tax expense for the quarter was up \$1.3 million, largely due to the higher pretax income levels partially offset by a \$700,000 excess tax benefit relating to stock compensation activity, including the effects of this benefit, our effective tax rate for the quarter was 23.5%, lower than expected, and down from 25.2% in Q1 last year. At this time, we continue to expect our full year effective tax rate to be within a range of 25 and 26%. On an overall GAAP basis, we therefore earn \$0.38 per share in Q1, up 31% compared with \$0.29 per share in Q1 last year.

To facilitate earnings comparisons, we typically adjust our GAAP earnings per share for unusual items recorded in the current or prior year quarters. In the current year quarter, we made adjustments to GAAP earnings per share to exclude acquisition related expenses, coronavirus related expenses, and purchase accounting expense effects. On this basis, our adjusted earnings for the first quarter was \$0.39 per share, up 30% compared with \$0.30 per share in Q1 last year.

Looking now at cash flow, where we generated \$5 million of cash from operations in Q1 this year. That represents an improvement of \$14 million over last year. While our operating cash flow was much improved in the first quarter, there is more uncertainty over the next few quarters given the pandemic. We are responding accordingly by taking actions to reduce our costs and prudently manage our liquidity.

During the quarter, we borrowed approximately \$64 million against our revolving credit facility, primarily to bolster our cash position in the short term and maintain flexibility. As a reminder, we executed a new five-year \$500 million credit facility last July. We can increase our borrowing capacity by an additional \$250 million dollars for acquisitions. We ended the quarter with \$210 million dollars of net debt and availability under our credit facility of \$211 million dollars. Our net debt leverage ratio remains at a comfortable level and is essentially unchanged from year end. Cash flow so far in April has met expectations with no material changes in customer delinquencies or bad debt. In fact, as of today, our net debt is lower than it was at the end of 2019.

We have implemented measures to manage our working capital and reduce discretionary capital expenditure without deferring certain key ongoing initiatives like our Vactor facility expansion. We are also planning to defer certain tax payments and retirement plan contributions in accordance with the provisions of the CARES Act. We have no debt maturities until July of 2024, and with our strong financial position, we are well positioned to navigate through these difficult times, and we remain steadfast in our commitment to add long term value to our stockholders.

On that note, we paid a dividend of \$0.08 per share during the first quarter, amounting to \$4.8 million, and we recently announced a similar dividend for the second quarter. Our Board also recently approved a \$75 million increase in our stock repurchase authorization, and during the quarter we spent \$13.5 million buying back almost half a million shares. We had about \$91 million of authorization remaining under our stock repurchase programs at the end of the quarter, but at this time, we have suspended any additional share repurchases until further notice, in order to preserve financial flexibility.

That concludes my comments, and I would now like to turn the call back to Jennifer.

Jennifer Sherman

Thank you, Ian.

Our first quarter represented a strong start to the year, but like many other companies, we expect that the next few quarters may be challenging in light of the current uncertainty relating to the COVID pandemic.

As Ian just referenced, our first quarter orders were strong, contributing to a record backlog at the end of the quarter. However, order intake at certain businesses so far in April has been slow.

In the first quarter TBEI, our business which manufactures dump trucks, bodies and trailers, reported its highest quarterly order intake under our ownership with Q1 orders up \$13.4 million or 25% year-over-year. During Q1, we saw traction on many of the strategic initiatives we have put in place. While the strong first quarter order intake provided a healthy backlog entering the second quarter, we have seen a significant drop off in orders so far in April. This decrease in orders is driven in part by the lack of available customer supplied chassis. As a reminder, unlike many of our other vehicle-based businesses at TBEI, the customer almost always provides the chassis. With many chassis OEM's shut down during April, some customers are not placing orders because they are unable to obtain a chassis or they are closed. We have started to see that relax a little over the last week as some of the OEMs have started to open back up.

We have also seen some softness in utilization levels of our rental fleet with rental income in the first quarter down about 8% compared to last year. In addition to factors related to the coronavirus, the lower utilization is also linked to reduced rental activity, with customers serving oil and gas markets.

While our exposure to oil and gas is a fraction of what it was in 2015 and '16, the recent depression in oil prices has contributed to lower utilization of the safe digging equipment in our rental fleet. It has also resulted in lower demand for replenishment units from some of our rental partners. We monitor utilization levels closely, and when we started to see the impact on our utilization levels, we started to scale back planned additions to our rental fleet. Our equipment retains its value well, and we are also taking actions to refurbish to extend the useful lives of our fleet, which currently has a weighted average age of approximately two years.

We continue to believe rentals are a highly strategic offering we can provide to our customers, and as many of our customers look forward to returning to work after the stay at home orders are lifted and suspended projects start back up, we anticipate rental utilizations will start to improve again. However, we

are expecting rental income in the second quarter to be down in comparison to the very strong performance we saw in Q2 last year. As a reminder, the second and third quarters are typically the strongest periods for our aftermarket business.

We are staying in close contact with our municipal dealers as they work through the challenges associated with the current situation. From our one on one conversations, the feedback that we hear is that municipalities still want and need the products that we make to support critical infrastructure needs, and that current parts and service demand is high as many end users are continuing to provide essential services like sewer cleaning.

During the first quarter, ESG recorded total part sales of \$33 million, which was a 7% improvement on a year-over-year basis. We continue to expect solid demand for replacement parts. We also expect our municipal end customers to benefit from the expanded funding of Apple to municipalities that was recently announced.

The current structure of our business is very different compared to the company that we were during previous downturns. We have a very different and wider variety of product offerings than we had during those times. For example, in our U.S. based public safety systems business, our main focus previously was on the higher end products for larger municipalities. We have significantly expanded the range and breadth of our products to include offerings in the good, better and best categories. We also now (inaudible) police vehicles, which is proving to be an effective strategy. As a provider of essential services to support first responders, our U.S. based public safety systems business had a strong first quarter and continues to perform well.

With the acquisition and divestiture activities over the last several years, and our revamped new product development process, we are a much more diverse company today. The composition of our businesses and the portfolio of products that we currently offer has allowed us to expand into new end markets. As the cornerstone of our operational philosophy, our 80/20 or ETI principles have become a key part of our culture.

Additionally, in the last period of economic uncertainty, the vast majority of our revenues were generated from the sale of new equipment. At that time, we generated a small percentage of our revenue from part sales but we did not actively participate in rental activity or used equipment sales. The acquisition of Joe Johnson Equipment in 2016 accelerated the growth of what we now refer to as our aftermarket business. The acquisition also doubled the number of service centers that we operate in strategic locations across North America, from which we can sell parts and used equipment, perform service work, and rent equipment. With that growth, our aggregate aftermarket revenues now represent about 24% of EFG's revenues.

In 2015 and 2016, we were heavily reliant on sales of new equipment into oil and gas markets. Since that time, we have diversified away from our reliance on any particular single end market through the combination of M&A and organic growth initiatives like our expansion into the utility markets for new product introductions. MRL and HighMark, the road marking and line removal business that we acquired last year actually grew during the last economic downturn and their order intake so far in 2020 has been in line with our expectations.

Yet even with these changes, there remains a high amount of uncertainty surrounding the potential business impact from COVID-19 and we are unfortunately not immune to the effects of the pandemic. As I mentioned earlier, our backlog at the end of Q1 was at a record level. However, the timing of production and realization of our backlog may be delayed or otherwise negatively impacted by a number of operational challenges we are currently experiencing during this pandemic.

The first challenge relates to the availability of labor. With the combination of the additional paid time off that we provided to employees to encourage sick employees to remain home and the enactment of the cares act, in recent weeks we have experienced a decrease in the availability of labor at several of our facilities. For example, we currently have between 50% and 60% of our hourly workforce working in our Vactor facility.

The second relates to supply chain disruptions and delivery challenges. Certain of our suppliers have temporarily shut either because of government orders, or other COVID related issues, including the availability of their employees. In addition, certain customers are unable to take delivery of our equipment, given the limited personnel that they currently have available.

The third item relates to the measures we have taken to ensure a safe work environment for our employees. These steps have included adjusting our production process at our facilities to comply with safe distancing guidelines in order to protect the safety of our employees. Each of these factors are having an impact on overall productivity. Although they had a limited impact on our first quarter results, we are expecting a more significant impact in the second quarter as we adjust our production schedules accordingly and we anticipate these factors may resolve and our productivity levels for certain of our businesses in the second quarter being down between 20% and 40% in comparison to prior year levels.

We are approaching the uncertainty and challenges in the second quarter and the rest of 2020 with resolve and from a position of strength given our current financial position. We are balancing the need to reduce our costs in the short term, but not at the expense of our longer term growth. At the same time, we are maintaining our focus on our 80/20 improvement initiatives. At certain businesses, we have taken steps to manage through these times including implementing our contingency playbooks and other measures to reduce costs and manage our capital prudently. Across the organization, we have significantly reduced discretionary spending and temporarily furloughed hundreds of employees, many of whom volunteered to take a temporary leave of absence.

One of my proudest accomplishments since becoming CEO at the beginning of 2016 is the culture that we've been able to build at Federal Signal. We are a team and we experience our successes, along with our trials together. With that in mind, our extended management team is taking salary reductions ranging from 20% to 25%. Each of our directors have also agreed to similar reductions in cash compensation.

The overall magnitude of the impact of the pandemic on our operating and financial results remains uncertain and will largely depend on the duration of the pandemic, and the measures implemented response as well as the effect on our customers. Given these factors, we are unable to reliably forecast the effect the pandemic will have on our financial results. As such, we are withdrawn our previously communicated adjusted EPS outlook for 2020. Our intent is to reinstate guidance for the remainder of the year with our second quarter earnings announcements.

As we start to look ahead with our Reclaiming Tomorrow, Together initiative, we're thinking of the future in three phases, with the first phase being the current situation. The second being the time when the various stay at home orders are lifted, with restrictions, and the third phase being the new normal in a post vaccine world. We expect to be well positioned to accelerate our growth as we emerge from the pandemic, and with that in mind, we've held a series of brainstorming sessions with the teams and ways that we can create or identify new business opportunities.

As part of this initiative, we are working on four primary areas. The first area focus is on ways to differentiate ourselves by improving the digital experience of our customers, employees. We have made investments in technology and established a team dedicated to support these initiatives, which include the launch of a revamped used equipment marketplace and the development of an e-commerce platform.

The second area is to generate ideas and how we can make our products and the ways in which we conduct our business safer for our employees, customers and end users of our equipment.

Third, is our focus and how we and our customers can use our equipment to clean and sanitize outdoor spaces. Our teams responded very quickly to this need. For those of you who have not yet done so, I would encourage you to visit fedsigresponse.com, which was launched in mid-March, to see the ways that our equipment can help them to clean up efforts. We are generating a lot of traffic to this website and this week, the number of page views hit the 40,000 mark, which was more than double the views last week.

Finally, we are aiming to identify opportunities to gain market share in the current environment. In many of the markets in which we operate, we tend to be the market leader and many of our competitors smaller, less capitalized operations. The provision of the SBA loans that were included as part of the CARES Act also contains a by American preference. In both cases, we believe that these represent opportunities for our businesses to gain market share. We're also monitoring developments relating to a potential infrastructure bill. If infrastructure legislation were to pass with our various businesses which support maintenance and infrastructure markets, Federal Signal would stand to benefit. We will continue to monitor any additional developments.

Our financial position is strong and will help us to navigate through the challenges we face today. At the same time, we remain committed to our long-term capital allocation priorities of investing in organic growth initiatives and funding cash returns to Shareholders. We also want to be in a position to participate in an M&A environment with much more reasonable valuation expectations than existed in the pre COVID world.

At this time, I think we're ready for questions. Operator?

Operator

Thank you. We will be conducting a question-and-answer session. If you would like to ask a question, please press star, one on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star, two if you would like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star keys. Once again that is star, one to ask a question at this time. One moment while we poll for our first question.

Our first question comes from Walter Liptak with Seaport Global. Please proceed with your question.

Jennifer Sherman

Good morning Walt

Walter Liptak

Thanks, good morning. Thanks for the detailed presentation. I want to ask first about the comments about the April orders? It sounds like TBEI had a great quarter but April slowed, I wonder if you could quantify it a little bit. And then also, the other products, some of the safe diggers and sewer cleaners, how are those trending in April?

Jennifer Sherman

Sure. The first thing I guess I would say is pretty limited sample size and the data has been pretty erratic, it changes day to day. It's very difficult to look at trends.

There have been pros and cons, overall, as we said, April orders had been slower. But let me try to give you some color or commentary. The first thing is our SSG orders are holding up pretty well. We have seen, as I talked about in my prepared remarks, some softness in TBI. To put that in context, TBI's orders in April look like they may be down on a year-over-year basis, somewhere in the range of \$8 million to \$10 million. But, in the first quarter, their orders were up \$13 million, or 25%, and they had the highest quarterly orders under our ownership. So, it's a bit of a mixed bag. A lot of the softness that we've seen is tied to customers not being able to secure chassis with many of the OEMs.

With respect to our other ESG vehicle-based businesses, it has been mixed. We're seeing some slower orders, but we've also had some fleet order wins. Last week, our Elgin team had a nice win. I think one of the things that you need to remember is with respect to safe digging, demos are really important there and we've been limited in our ability to demo. Some of our customers have been closed or have other priorities and that has been challenging for us during the quarter.

Finally, we talk about 50% of our employees are located in Illinois, and as you know Walt, Illinois had one of the first stay at home orders and one of the most restrictive stay at home orders. That's created some additional challenges in terms of visitation with customers over the quarter. We believe that our Reclaiming Tomorrow, Together initiative over the long run will be important as we educate customers on how we can use our equipment to sanitize outdoor spaces. We're also looking at some other types of products at our SSG business. The nutshell is it's a very mixed bag, but orders are down.

Walter Liptak

Okay, got it. Wanted to switch gears and just ask about M&A. There's a drop in M&A expenses. I wonder if you can talk about that and what the pipeline for M&A looks like.

Ian Hudson

Well, I'll take the first one. Well, if the drop in the M&A expenses is really a function. We have—the earn out, we have accrete that liability. It wasn't there last quarter, in last year because we didn't own MRL. So this quarter, it's down because of the level of activity. In Q1 of last year, we were working pretty much full speed on the MRL acquisition. This year because of various travel restrictions, the M&A activity is down. That's the year-over-year variance.

But Jen can talk more about kind of what we're seeing in the M&A space.

Jennifer Sherman

Sure. We continue to believe that M&A will be a critical part of the growth for our future. I had spent a good portion of January and February in active dialogue with many M&A candidates. We've put that on pause now. We believe that there could be opportunities for us going forward at valuation levels that are more reasonable than they were perhaps pre pandemic. But, we continue to be encouraged by the quality of targets and the strategic fit of the opportunities that are available, and I've continued as many other members on our team have an active dialogue with those companies.

Walter Liptak

Great, thank you.

Operator

Our next question comes from Chris Moore with CJS Securities, please proceed with your question.

Chris Moore

Hey, good morning guys

Jennifer Sherman

Good morning

Chris Moore

Good morning. Yes. Maybe you can talk a little bit about the, more about the supply chain challenges. Other than the kind of the chassis related issues you talked about, are there other specific areas of concern, and how much visibility do you have in terms of things improving a little bit?

Jennifer Sherman

Yes, so, the chassis challenges have really been at our TBEI businesses. With respect to our LG business, for example, our largest product line is Pelican. We build our own chassis there. For our Vactor business on, it's about half the time we acquire the chassis, the other half the time the customer acquires the chassis. So, given the longer lead times the Vactor business, we're in pretty good shape there with respect to chassis.

Supply chain issues have been—we've had a couple issues out of Mexico, we had an issue out of Italy with some transfer cases. What I've been impressed with is the ingenuity of the teams in terms of addressing it. For example, we had a harness issue out of Mexico and our teams figured how to redeploy field technicians to make these wiring harnesses at home, and went through our quality testing and the teams did a super job.

The other challenge has been in some situations, just transportation to get the supplies to our various facilities. That has had an impact on productivity. But our productivity issues are broader than just supply chain, and maybe I can give you an example that would be helpful, is at Vactor which is our largest plant, we have an initiative that I've talked about several times with all of you called BMT, Build More Trucks. I'm pleased to report that in February, we hit a record on that initiative in terms of productivity.

Unfortunately, we started to see the impact of the pandemic in March and productivity from the February high reduced 10%. Then in April, we saw more meaningful impact and it reduced 40%. So why? A couple of things. One is Vactor, we were doing a \$25 million plant expansion, both to support future growth, but also to give us more room to operate. We worked with the local management team and we put together a productivity plan that was significantly less than February to accommodate labor availability, need for safety, supply chain challenges and we laid off a number of people. Our current expectation is that those people will return at the end of June, but those productivity challenges that are related to not only supply chain, but also to labor availability, willingness of customers to take delivery is impacting productivity pretty significantly.

Chris Moore

Got it. All extremely helpful. I'll jump back in line. Thanks guys.

Operator

Our next question comes from Ken Newman with KeyBanc. Please proceed with your question.

Jennifer Sherman

Good Morning, Ken.

Ken Newman

Hey, good morning guys. Hope you all are well and healthy.

Jennifer Sherman

We are, thank you.

Ken Newman

I just wanted to touch back on the production ranges that you gave for 2Q. Do you have any color on how much finished product you have in the backlog today? Or I guess, another way of asking is do you expect revenue to be down less than production?

Ian Hudson

Yes. I think in terms of the second part of the question, Ken, I think it's—at that time, it's just too uncertain to kind of predict that with any reasonable degree of accuracy. We're in the first month of the quarter and we've given some stats on kind of what we've seen from a production standpoint. It's down anywhere between 20% and 40% of some of our businesses. I think it's—in terms of the finished goods, we did have slightly higher finished goods at the end of March. Really, as Jennifer mentioned, there are certain customers that were just unable to take delivery of the equipment, just given the fact that they didn't have employees available to take delivery. A finished good balance at the end of the quarter was a little high. It was about \$93 million, \$94 million. So, it's up about \$7 million from where it was at year end. We had expected those units to ship at some point during the second quarter. But again, we are seeing some delays in terms of deliveries just with the limited number of employees that our customers have.

Ken Newman

Got it. That's helpful. And switching over to the margins, I know the demand uncertainty kind of hits you in the middle of a couple of expansion initiatives, just given all the variables just around volumes and fixed costs, any way you can give us a framework for how you're thinking about operating leverage or decremental margins into the quarter for the year?

Ian Hudson

Yes. It's really—it's difficult, Ken, as you can probably imagine. I mean, the decremental margins can vary for us from business to business and it can vary widely based on the assumption of the volume deterioration and kind of the mix of the products that's affected. Just a couple of data points I can give you is if you go back to 2008, 2009, between those dates, decremental margin was about 20%. Between '15 and '16, it was a little higher than that. But again, we were a very, very different company to what we were back then, because it's diversification of our end markets, our revenue stream. I think those data points are data points, but they may not be tremendously accurate.

I think with so much uncertainty, I don't think we're in a position to really size it that much. But we have target EBITDA ranges for each of our businesses. Those are intended to be through the cycle margin targets. At this time, we're not really sure if we're in what we would call a typical cycle. I think it's fair to say we didn't necessarily consider a global pandemic when we set those targets, but our goal is to continue to operate within those ranges, and as we talked about some of the cost reduction initiatives that we took in the early part of the second quarter, those were designed with the goal of operating within those target ranges.

Jennifer Sherman

Yes. I think I'll add there that, I think that's really important is that we acted pretty swiftly as we started to adjust production levels, and I gave the example, we've taken over \$10 million of cost out in the second quarter and we're going to continue to monitor that and we will adjust accordingly, and it's with those target EBITDA ranges in mind. But I'll add as though Ian said is these are highly unusual circumstances.

Ken Newman

Yes. I totally understand that. I guess, just as a follow-on to that, obviously, the corporate expense and the SG&A margins were lower this quarter than we had expected and held in pretty quickly or pretty well. I'm just curious barring obviously the uncertainty from COVID, just how sustainable are margins at this level, if we were to go back to like a normalized cycle type of environment.

Jennifer Sherman

For back in the normalized cycle, yes, they're sustainable.

Ken Newman

Got it. Okay, thank you. That's very helpful.

Operator

Once again ladies and gentlemen, to ask a question, please press star, one on your telephone keypad.

Our next question comes from Marco Rodriguez with Stonegate. Please proceed with your question.

Marco Rodriguez

Hi, good morning guys. Thank you.

Jennifer Sherman

Good morning, Marco.

Marco Rodriguez

Thank you for taking my question. I was wondering if maybe you could talk a little bit about your thoughts on recoveries, if you will. I mean, I know this is very difficult and I'm assuming your crystal ball is no better than anyone else's, but I'm assuming you guys have run through a lot of different scenario analysis on potential outcomes for your business through Fiscal '20. Maybe if you can kind of share a little bit of color around what your base case scenario kind of looks like. What your expectations are as far as recoveries are concerned.

Jennifer Sherman

Yes. So Q2, it's going to be tough. Beyond Q2, it's—we'll update you at the end of Q2. We started really early on the offense. If you think about our Reclaiming Tomorrow, Together initiative, it has four parts. We adjusted pretty quickly. We have four parts to that initiative in terms of our digital market share part of that initiative, our outdoor sanitation, cleaning outdoor spaces initiative. You think about that, we launched that mid-March, and it still needs to be proven out, but we're gaining traction. I think some of those initiatives are going to be important to recovery.

We're also in a position where we have record backlogs. Our backlog is over \$400 million, and it allows us the luxury of being able to optimize production, which sounds like strange words in very difficult time periods.

We can work with our customers to make sure they get the equipment they need when they need the equipment. I've been really impressed with some of how the new product ideas that people are going to need in this new world, and we're working diligently on that. I think we've proven in the past that our new product development machine is a much different machine than it was during previous downturns.

A lot of what you ask is going to depend on traction on some of these initiatives and the overall impact on our customers. We still have customers that are important customers that are closed. They're very encouraging when we talk to them. They appreciate our partnership, and as soon as they open their—we think we're going to be in a great position to serve them, but there's still a lot of unknowns.

Marco Rodriguez

Okay, that's helpful. Then kind of switching here towards the municipal market, you provided some great color here in terms of how you guys are positioning yourself (inaudible) wise to really drive an increase market share there. I was wondering if maybe you could share if you have any, any early indications of demand increases or lack thereof from municipal and government customers.

Jennifer Sherman

Yes. I think a couple of things that are important is, historically, municipal and government customers don't cancel orders and they haven't canceled any orders in any kind of meaningful way. That's the first thing that's important to understand.

The second thing is, frankly, in some situations I don't believe delivery of our product has been a top priority. For example, for some of the larger municipalities, they're dealing with the challenges, the pandemic. But what I would—I think it's really important to remember is that we—many of our products are essential products, and we're working to make them more essential. The whole purpose of Reclaiming Tomorrow, Together initiative is in terms of helping the company going forward, but also helping our customers. We believe that there are opportunities to repurpose this essential equipment to assist in outdoor cleaning and that will benefit both our customers and Federal Signal in the long run.

Marco Rodriguez

Got it. Last quick question, just kind of a clarification. I believe you guys had mentioned on productivity level, you saw about a 20% to 40% decline year-over-year. Is that specific to any particular areas of your business, or was that sort of a general comment across all your businesses if you will?

Ian Hudson

It really varies, Marco, across each business. I think we talked about SSG University Park in Illinois, that's the business that supports the SSG business, supports primarily the emergency first responders. That business is taking along quite nicely. The order intake has been good. They had a great quarter.

At some of our vehicle-based businesses, again, it varies based on the state that you're operating in with the various stay-at-home orders that are in place. We have three facilities in Illinois. The stay-at-home orders are in place and so while we are an essential business, there has been an impact, as Jennifer talked about, on the productivity level.

I would say that at our Vactor facility, we've seen a higher degree of an impact from the productivity issues that Jennifer described. That's probably towards the higher end of that range.

Jennifer Sherman

I would add is our Spanish facility was closed down by the government for two weeks. They're back up online. So, all of that is going to contribute to the second quarter results.

Marco Rodriguez

Understood. Thanks a lot. Appreciate your time.

Ian Hudson

Thanks, Marco.

Jennifer Sherman

Thank you.

Operator

Our next question comes from Steve Barger with KeyBanc. Please proceed with your question.

Steve Barger

Hey, good morning. Sorry, I got on late. Another call ran over. I know Ken was already on, but I just had a couple of quick follow-ups.

Jennifer Sherman

Sure.

Steve Barger

I may have—maybe you addressed this already, but when you think about lower production, supply chain or labor issues and then offset by the cost actions you're taking, do you expect you get the positive swing in free cash flow that a revenue slowdown typically brings in the next couple of quarters? Or will that be hindered by the circumstances?

Ian Hudson

Yes. I think, Steve, we're monitoring our cash levels very closely. I think—I don't know if you heard on the call, but we talked about our cash balances as of today, and what we've seen in April to date. Our net debt position as of today is actually lower than it was at the end of 2019. We're pretty encouraged with the cash flow that we've seen so far in April, but it's early days. I think we're continuing to expect that we're going to generate good cash flow as we have, even if you go back to the 2015, 2016 timeframe, we were positive for operating cash flow. We've put some things on pause that we talked about.

We've put some of the discretionary cap ex that's been on pause. We're continuing to pay the dividend, but we have suspended further share repurchase. So we're encouraged with what we've seen so far, but I think it's another—it's something that we're continuing to monitor. We put in a number of working capital measures in place, as you can probably imagine, and we're encouraged so far with what we've seen.

Jennifer Sherman

I guess the only thing I would add is that longer-term, longer-term can be end of third quarter, fourth quarter these days, we really believe there's some good M&A opportunities.

Steve Barger

Right. Would that be more on the ESG side or safety?

Jennifer Sherman

ESG.

Steve Barger

Okay. That's great.

Jennifer Sherman

There are some smaller ones on the safety side also that we're taking a look at. But the relatively, larger ones would be on the ESG side.

Steve Barger

Right.

Jennifer Sherman

But again, I think we've proven ourselves to be pretty prudent in valuation. We've continued to do so. Like other companies, we believe that valuations will be more reasonable than pre-pandemic.

Steve Barger

Yes. No, I think that makes sense. Have you actually seen the bankers coming to you talking about resetting prices on deals that you may have previously vetted? Or, is that more of a proactive assumption that will take place?

Jennifer Sherman

I think bankers have generally been on kind of a quasi-pause. But, as we've talked about in the past, we've developed relationships with a number of different acquisition candidates, and we continue to—we continue that dialogue. Nothing's going to happen in the second quarter. But we think it's critical. We continue that dialogue, and M&A will be an important part of our future, and there's some really good strategic acquisitions out there.

Steve Barger

Great. Then last on Slide 13, you're talking about your four initiatives. First one being improving digital customer experience. What does that really mean? What have you invested in? What does that look like to the customer? How does it help?

Jennifer Sherman

Sure. A couple of things. One is we are rapidly, and we have a very, very aggressive timeline, our people will tell you, increasing the number of videos that we have about our products, about training. We're looking at contact-less delivery in terms of what we can do. I've been impressed by the speed, and we've got teams around that, e-commerce is a critical part of our future, particularly for our SSG businesses. We are committed to that and continuing that particular initiative. We believe it's an opportunity to really distinguish us from some of our competition, considering that many of our competitors are smaller entities and this will be an area of focus as we move forward.

Steve Barger

For contact-less delivery, is that having a third-party auditor come in and verify the machine is built to spec? Or, is that something that you would do internally via a video call or something as you inspect the vehicle?

Jennifer Sherman

Yes. I think it really focuses on both the inspection and the training that's necessary to use many of our complex pieces of equipment. The teams have—we started this over five weeks ago, six weeks ago, and just the content that we've already been able to deliver that allows us to deliver the equipment, do the inspection remotely and do the training remotely. That's critical as we move forward. We're also looking at ways of how do we make our equipment safer for the end users to the equipment. What do I mean by that is we have multiple people that come in and out of trucks. We're working on methodologies that's going to allow you to sanitize in between uses quickly and efficiently.

Steve Barger

I'm curious, do you think that this indirect inspection and contact-less delivery and video training will represent a permanent change in how business gets done? Or, do you think this is just you bridging the gap to things getting back to normal?

Jennifer Sherman

Yes. I think it's probably a combination of both. Our dealers play a critical role in the delivery of our Vector, TRUVAC and Allegiant equipment. Our customers' training is important. A lot of times, it isn't just a onetime training because you either have new employees. This equipment is pretty complicated, and there's a variety of different uses. I think that you'll see more digital training, but it's not going to replace some of the face-to-face opportunities that our customers require.

Steve Barger

All right. Thanks for the time.

Jennifer Sherman

Thank you.

Operator

Our next question is a follow-up from Walter Liptak from Seaport Global. Please proceed with your question.

Jennifer Sherman

Good morning, Walt.

Walter Liptak

Hi, thanks. I just wanted to ask a follow-up. From your prepared remarks, you talked about some of the sewer system challenges that some of the municipal, the cities are having some sort of problem. I wonder if you could provide some detail on that. What kind of services is Federal Signal providing to help solve those city problems?

Jennifer Sherman

Yes. Those challenges are really driven by a couple of things. One is initially the lack of available toilet paper, and people were using things they shouldn't use in the sewer systems. Number two is our habits have changed quite a bit. Everyone used to go to work and school, and now people are at home. It's put a lot of strain on certain sewer systems. There's actually quite a social media campaign by different water departments on this particular issue, trying to educate end users about this. As a result, you need to clean the sewers more frequently. There's been clogs, there's been backups and our equipment has become more essential than ever.

One other thing I would add, Walt. The one other thing I would add there is parts. We talked about on the call, our parts business, not only for us, has been solid in April, but we've talked to a number of our dealers, and they're continuing to see very strong parts business during April.

Walter Liptak

Okay, sounds great. Then the cap ex, you mentioned there was some reduction there. I wonder if you could—maybe I missed this, but what is the cap ex going to be for 2020?

Ian Hudson

Yes. Walt, the estimate is between \$25 million and \$30 million for the year, and some of that is kind of the already committed spend on the expansion of Vactor and Rugby, North Dakota. It's come down by about \$5 million right now, but it's something that we are continuing to evaluate, and we're looking at things with the delay of the expansion that we talked about. Some of the payments will be made over a longer period of time as opposed to more. We were originally anticipating those, but those would be more heavily weighted in the first half of the year. Those may be spread a little more evenly throughout the year.

Jennifer Sherman

Yes. I want to be clear on the Vactor expansion. We had put that on hold because of the visitor policy that we had in place, and we didn't want outside visitors in. Since we put on hold, we've reinitiated that project with additional controls in place, and it's about a quarter behind. But we are close to finished, and we expect that we should be finished by the end of the third quarter. It's an important project, particularly for safe distancing for us.

Walter Liptak

Okay, great. Thanks. Good luck for the second quarter.

Jennifer Sherman

Thank you.

Operator

Our next question comes from Greg Burns with Sidoti & Company. Please proceed with your question.

Jennifer Sherman

Good morning, Greg.

Greg Burns

Good morning. Thanks for squeezing me in here. You mentioned you haven't really seen any cancellations on the municipal side. But on the industrial side, since the end of the quarter, have you seen any movement in the backlog, either customers delaying or pushing things out or canceling? What's been happening on the municipal side with your customers from the demand perspective?

Ian Hudson

Yes. On the municipal side, as Jennifer mentioned, very little in terms of cancellations to date in April or historically. We rarely see that because if you think about the municipal side of the business, it's often part of our public RFP (phon), the purchase of our products. It's quite rare that we see any cancellations.

We've seen some on the municipal—sorry, on the industrial side in the past. We had a little bit of that in—so far in April. But all of those—the impact of those cancellations are reflected in the backlog that we reported, and it's still at record levels. That should give you some idea that we're not talking about a material amount of cancellations given that the backlog at the end of the quarter was at a record level.

Greg Burns

Okay, thanks. Then just talk about the complexion of your oil and gas exposure now versus maybe in '15, '16. I think it's less whole goods, maybe more rental oriented, but can you just talk about maybe your exposure there? How the business has changed maybe from '15, '16 till now?

Jennifer Sherman

I'll start and maybe Ian can add some color, is that back in '15 and '16, we sized to around \$90 million. We now size it around \$30 million, and we diversified our end markets as I talked about in my prepared

remarks, significantly through both M&A and our organic initiatives. Our exposure is really—a lot of it's around our rental fleet and replenishment of that rental fleet. Although, I would add that we believe that the rental fleet will be an important strategy as people continue to come back to work and projects are restarted, and we expect our rental rates, rental utilization to increase as we move through the second and third quarter.

Ian Hudson

Yes. We've seen it, Greg, I think Jennifer talked about on the—in the prepared remarks. We've seen some of the effects of the depressed oil prices on our utilization rates of our rental fleet, primarily the safe digging equipment. Rental income in Q1 this year was down about 8% over Q1 of last year. It's also—some of our rental partners are also seeing the same thing. It's affected some of the new orders from some of our rental partners for safe digging equipment.

Greg Burns

Okay. How much did Mark Rite Lines contribute to orders and backlog this quarter?

Ian Hudson

It was about—so MRL, the—it was about \$16 million in Q1.

Greg Burns

For orders and backlog growth or...

Ian Hudson

Yes. They would be—that would be the orders they received in the first quarter. Some of those, although it will be a very small part, would have shipped out in Q1. The addition to backlog would have been probably somewhere in the \$5 million range.

Greg Burns

Okay. And then—so looking at the ESG orders then, down 2.5%, it sounded like TBEI was strong in the quarter. Sorry, that was down, but if I back out the contribution from Mark Rite Lines, where were you seeing the most weakness? Was it TBEI? Or, was there other areas where orders were starting to decline a little bit?

Ian Hudson

Yes. You're right, TBEI was strong. The safe digging was down, probably the most significantly, and really, as Jennifer talked about the fact that the demos and presentations are a real factor in the sale process there, and with the restrictions that we've had in place on travel and attendance at trade shows, given a lot of what we've seen have been kind of the fruits of a lot of almost missionary work where you're trying to educate people on to the efficiency benefits of our products as well as the safety benefits.

Our sales team hasn't really been able to get out there and to kind of demonstrate those features. We've seen some impact on incoming orders. I will say that our backlog is still very, very strong. Again, the record backlog at the end of the quarter includes a good amount of safe digging equipment. That's one of the other factors to consider.

Jennifer Sherman

Yes. I guess the other thing I want to add about safe digging, that's important to understand is that despite these quarterly challenges, longer term, this is a—remains a critical part of our growth, and several of our smaller safe digging competitors have a much higher reliance upon oil and gas. We believe going forward, given our diversified end markets that this will create opportunities for us.

Greg Burns

Okay, great. Thank you.

Operator

At this time, I would like to turn the call over to Jennifer Sherman for closing comments.

Jennifer Sherman

These are tumultuous and uncertain times, there's no denying. This experience has confirmed my strong belief that our workforce is unparalleled in its passion, commitment and grit, and while these days may seem tough, I'm confident that we will ban together and work through these challenges as we have many others. We are nimble and have moved quickly.

In closing, I would like to thank our stockholders, employees, distributors, dealers and customers for their continued support. During this pandemic, I've implemented a new rule, which requires us to end all internal discussions on a positive note. Applying my own rule to this call, I would encourage us all to think about the fact that never before has the entire world been collectively focused on one thing, developing and producing a vaccination for this disease. There are currently over 70 active vaccine trials, and I, for one, would not (inaudible) against the U.S. or world innovation machine. I'm also optimistic about the long-term future of our Company. I firmly believe that although 2020 will be challenging, Federal Signal will be stronger going forward.

Thank you for joining us today. Be safe, and we'll talk to you soon.

Operator

This concludes today's teleconference. You may disconnect your lines at this time, and thank you for your participation.