



Federal Signal Corporation
Second 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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P R E S E N T A T I O N

Operator

Greetings, and welcome to the Federal Signal Corporation Second Quarter Earnings Conference Call.

At this time, all participants are in listen-only mode. A brief 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.

It is now my pleasure to introduce your host, Ian Hudson, Chief Financial Officer. Thank you, you may begin.

Ian Hudson

Good morning, and welcome to Federal Signal's Second 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'll 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 second quarter financial results before turning the call back to Jennifer to give a business update and provide thoughts 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.

I'd like to start by giving my profound thanks to each of our employees and our dealer partners for their commitment over the past several months. Since the outbreak of the pandemic, a critical area of focus has been on their health and safety, and we have implemented a host of new measures to ensure a safe work environment for our employees.

These steps have included adjusting our production processes at our facilities to comply with safe distancing guidelines in order to protect the safety of our employees. We have also invested in temperature screening capabilities at many of our facilities, issued a face mask policy and provided our employees with additional paid time off.

These are clearly challenging times at many different levels. But I could not be prouder of our performance during the second quarter with our teams demonstrating impressive operational execution in exceptionally difficult circumstances, while at the same time continuing to provide a safe working environment for our employees.

Each of our businesses is considered essential in supporting critical infrastructure needs and public safety. That meant that all of our manufacturing facilities remained operational throughout the quarter, albeit with certain of our operations temporarily affected by facility closures, either due to government issued mandates or other coronavirus-related issues.

At the beginning of the quarter, we acted quickly and decisively in response to a variety of operational challenges resulting from the pandemic by adjusting our operating costs and modifying our production schedule. As our teams developed strategies to operate in the new COVID environment, we experienced double-digit sequential improvement in average weekly sales in both May and June. The combination of these factors helped us to maintain a high level of performance and deliver an Adjusted EBITDA margin of 16.8% in the quarter, exceeding the upper end of our target range.

The strong results that we were able to deliver in exceptionally difficult circumstances during the quarter, were a testament to the quality of our businesses, our experienced leadership team, the commitment of our employees and the agility of our teams.

While managing through this difficult quarter, we also continue to focus on our long-term growth initiatives. For example, on the organic side, we introduced a new regenerative air sweeper that does not require the operator to have a commercial driver's license. We also made progress on our plant expansion at Vactor, Rugby and MRL, which will initially provide additional space for social distancing and additional capacity to support our longer-term growth. On the M&A front, we completed the acquisition of PWE.

In addition, I'm also pleased to report that the Company will be issuing our inaugural long-form sustainability report later in the third quarter.

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

Ian Hudson

Thank you, Jennifer.

Our consolidated second quarter financial results are provided in today's earnings release. In summary, our teams continue to execute at a high level, with both of our groups delivering Adjusted EBITDA margins in excess of the target ranges.

Consolidated net sales for the quarter were \$260 million (phon) compared to \$324 million last year. Consolidated operating income in Q2 this year was \$31.3 million compared to \$46.3 million last year. On an adjusted basis, consolidated operating margin in Q2 this year was 12.7% compared to 14.6% last year. Consolidated Adjusted EBITDA for the quarter was \$45.4 million compared to \$57.1 million in Q2 last year. That translates to a margin of 16.8% in Q2 this year compared to 17.6% last year.

Net income in Q2 this year was \$21.4 million compared to \$32.8 million last year. That equates to GAAP earnings of \$0.35 per share compared to \$0.54 per share last year. On an adjusted basis, EPS for Q2 this year was \$0.42 compared to \$0.55 in Q2 last year.

Orders in Q2 this year were \$201 million compared to \$308 million last year. Despite the lower orders, our backlog at the end of the quarter remained healthy at \$333 million. That compares to \$348 million in Q2 last year.

In terms of our group results, ESG sales for the quarter were \$214 million compared to \$267 million in Q2 last year. ESG's operating income was \$28.6 million compared to \$44.8 million in Q2 last year. ESG's Adjusted EBITDA for the quarter was \$40.9 million compared to \$54.4 million a year ago. That translates to an Adjusted EBITDA margin of 19.1% in Q2 this year compared to 20.4% last year. ESG reported total orders of \$158 million in Q2 this year compared to \$253 million last year.

SSG's second quarter sales were \$56 million this year compared to \$57 million last year. SSG's operating income for the quarter was \$10.4 million, up from \$9.5 million in Q2 last year. SSG's Adjusted EBITDA for the quarter was \$11.7 million compared to \$10.3 million a year ago, and its Adjusted EBITDA margin in Q2 this year was 20.9%, up from 18% last year. SSG's orders in Q2 this year were \$44 million compared to \$55 million last year.

Corporate operating expenses in Q2 this year were \$7.7 million, down from \$8 million last year. Turning now to the consolidated income statement, where the decrease in sales resulted in an \$18.7 million reduction in gross profit. Consolidated gross margin in Q2 this year was 26% compared to 27.4% last year. Our results in Q2 this year included the recognition of approximately \$3 million of excess overhead costs that flow through the income statement as inventory period costs due to lower production levels.

Selling, engineering, general and administrative expenses for the quarter were down \$4.4 million from Q2 last year.

Other items affecting the quarterly results include a \$600,000 reduction in acquisition-related expenses, a \$1.3 million increase in restructuring charges and a \$200,000 decrease in interest expense, largely due to lower average interest rates in comparison to the prior year quarter. Other expense in Q2 this year was also \$2.1 million higher than last year, primarily due to the recognition of a \$2.5 million charge associated with the withdrawal from a multi-employer pension plan.

Tax expense in Q2 this year was down \$5.5 million compared to the prior year, largely due to lower pretax income levels and the recognition of a \$1.1 million excess tax benefit related to stock compensation activity. Including the effects of the excess tax benefit, our effective tax rate in Q2 this year was 22.2%, lower than expected and down from 26.1% in Q2 last year. At this time, and assuming no additional excess tax benefits, we expect our full year effective tax rate to be approximately 25%.

On an overall GAAP basis, we therefore earned \$0.35 per share in Q2 this year compared with \$0.54 per share in Q2 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, pension-related charges, restructuring activity, coronavirus-related expenses and purchase accounting expense effects. On this basis, our adjusted earnings for the second quarter were \$0.42 per share compared with \$0.55 per share in Q2 last year.

Looking now at cash flow, where we generated \$60 million of cash from operations in Q2 this year. That represents an improvement of \$25 million or 73% from Q2 last year. The year-over-year improvement was primarily due to working capital timing differences, inclusive of actions taken early in the quarter to preserve short-term liquidity in response to the pandemic, lower rental fleet investment in comparisons to the prior year and deferrals of certain payments in the current year as outlined in the CARES Act.

During the quarter, we paid down approximately \$36 million of debt, completed the acquisition of PWE and funded cash returns to stockholders. We ended the quarter with \$171 million of net debt, which is down from \$210 million at the end of Q1 and current availability of \$245 million under our credit facility.

As a reminder, we executed a new five-year \$500 million credit facility last July. We can increase borrowing under that agreement by an additional \$250 million for acquisitions.

Our net debt leverage remains low and essentially unchanged from year-end. Cash flow so far in July has met expectations with no material change in customer delinquencies or bad debt. With no debt maturities until July 2024, we are continuing to approach the uncertainty and challenges with resolve, and from a position of strength given our financial position, which has improved further since the end of the first quarter.

We also remain committed to adding long-term value to our stockholders. On that note, we paid a dividend of \$0.08 per share during the second quarter, amounting to \$4.9 million, and we recently announced a similar dividend for the third quarter. Although we did not buy back any shares in Q2, we currently have about \$91 million of authorization remaining under our stock repurchase program.

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

Jennifer Sherman

Thank you, Ian.

As you will have seen in today's release, we reinstated guidance for the year. There were several factors that gave us confidence to do this and provide us with optimism as we look forward. First, we clearly demonstrated that we can manage our costs. As we have discussed previously, we aim to consistently operate within our target EBITDA margin ranges. In an effort to mitigate the financial statement impact of many of the pandemic-related operational challenges, we implemented a number of cost-saving actions during the quarter. The actions that we took helped us to maintain a high level of performance and deliver an Adjusted EBITDA, which exceeded the upper end of our target range. These actions included temporary employee furloughs, salary reductions for the Company's enterprise leadership team, reductions in director fees and limits on discretionary spending.

We estimate that these actions resulted in Q2 cost savings of approximately \$14 million in comparison to our plan for the year. As a result of anticipated gradual improvement in our production levels, we have brought back many of the furloughed employees, although we did complete a reduction in force. We also made the decision to roll back the annual merit-based salary increases for most domestic salaried employees effective in the third quarter. We are currently targeting similar savings in the second half of the year as we realized in the second quarter.

Now turning to current demand. We entered the second quarter with backlog at record levels and lead times for certain product lines extended. As we move through the quarter, our incoming order rates increased. As we mentioned on our first quarter earnings call, order intake in April was slow with the various government-mandated stay-at-home orders and travel restrictions significantly impacting our sales and marketing activities.

For much of the quarter, our sales teams were unable to attend trade shows, perform equipment demonstrations or conduct in-person sales meetings. In addition, certain customers were unable to take delivery of equipment, given travel restrictions and the limited personnel they had available. These factors significantly impacted our order intake. However, as the second quarter progressed, many of the government-mandated restrictions that were imposed in states across the U.S. started to ease, albeit at different times and at different levels.

With that, and with sales travel fully resuming, we have seen a commensurate increase in equipment demonstrations. To illustrate, we were able to complete 125 demonstrations and presentations of our TRUVAC branded vehicles in June of this year. Which was double the amount performed in April and may combined and slightly more than in June of last year. Since April, we've also seen monthly increases in the amount of presentation and demos of our street sweepers and sewer cleaners. This has contributed to sequential improvement in our average weekly order intake in both May and June. Our weekly average orders in May were 16% higher than April, and our weekly average orders in June were 24% higher than May.

We are encouraged with what we have seen to date in July, with improvement in demand for sewer cleaners and safe digging trucks noted since June. While these are promising signs, our June orders were not back to the levels that we saw last year. Note, the outstanding orders that we've reported in the third quarter of last year included a \$27 million of acquired backlog for the—from the MRL transaction. Within our specific end markets, we have seen the quickest recovery within our truck bodies business.

As you may recall, on our last call, we talked about a significant drop-off in orders that we had seen in April, driven in large part by the lack of available customer-supplied chassis at one of our TBEI locations, with many of the chassis OEMs shut down. As a reminder, unlike many of our other vehicle-based business, at TBEI, the customer almost always provides the chassis. That situation improved as the quarter progressed, as evidenced by the flow of chassis deliveries into our facilities. It reached a low point

of approximately two deliveries per day in May. Whereas in June, that improved to around eight a day. While it's still not back to typical levels, we have noted further improvement in July.

The second quarter is typically seasonally strong for TBEI, and despite the supply chain issues and the effects of the pandemic, TBEI was able to deliver its highest quarterly EBITDA margin since we completed the acquisition three years ago.

Third, we have seen resilience in our aftermarket and SSG businesses. Our aftermarket business represented approximately 26% of ESG's revenues for the quarter, which is up from 24% in the first quarter and in Q2 last year. We continue to see solid demand for replacement parts in the quarter with part sales of \$31 million. The softness we saw in utilization levels of our rental fleet during the first quarter continued into May, but we did see signs of improvement in June, most notably in Canada, where utilization levels approached prior year levels. Overall, our rental income in Q2 was down in comparison to a very strong comparative in the prior year quarter but was up 6% versus the first quarter. Our safety and security group demonstrated its resilience with impressive performance in Q2 this year, generating higher income on slightly lower sales compared to the prior year. Its Adjusted EBITDA margin for the quarter was outstanding at almost 21%.

Fourth, we have diversified our public revenue funding sources. While the pandemic has impacted the financial health and municipalities, we are positioned so that our exposure to public funding mechanisms is diversified with multiple funding sources. Our businesses in both ESG and SSG are deemed essential, and we see market share gain opportunities and are encouraged by potential future opportunities as we see catalysts for growth. All of this I will explain in further detail.

Historically, approximately 60% of Federal Signal's revenues were generated from some kind of public funding mechanisms. Over the course of the last several years, through a combination of acquisitions and organic growth initiatives, that percentage is now less than 50% as the growth in our industrial and rental business has outpaced that of our public funded revenue stream.

Furthermore, our publicly funded revenue streams include revenues that are generated from sales to municipalities outside the U.S., most notably in Canada, following the acquisition of Joe Johnson in 2016 and in Europe through our VAMA business located in Spain. We have also seen significant growth in the last two years in export sales of our public safety products to customers in Latin America.

Within ESG, our two primary products sold to U.S. municipalities are sewer cleaners and street sweepers, sewer cleaners represent our largest product line in terms of sales. Sewer cleaner purchases are typically funded through water taxes as opposed to general municipal funds. Both sewer cleaners and street sweepers provide essential services and the focus on cleaning remains utmost important during and after this global pandemic.

Through our Reclaiming Tomorrow, Together initiative, we are also identifying ways to make our equipment even more essential. As an example, our sewer cleaners are being used to clean the Field Museum in Chicago prior to its reopening. Within SSG, our sales to municipal customers are primarily represented by sales of public safety products to emergency first responders and systems that warrant inhabitants of weather-related dangers like tornadoes or tsunamis. Certain of our new technology offers are funded through the emergency fees charged on user cell phone bills.

Fifth, we are monitoring developments relating to a potential infrastructure bill, which would be a catalyst for growth for many of our businesses. The proposed \$1.5 trillion bill that was recently passed by the House of Representatives includes funding to repair roads and bridges, expand broadband access in rural areas and to rebuild and modernized American infrastructure with significant investments in public transit, the energy grid, clean water and wastewater systems, affordable housing, school and hospitals.

The legislation also includes Buy America procurement requirements. If such infrastructure legislation were to pass, with our various businesses which support maintenance and infrastructure markets, Federal Signal will stand to benefit.

Specifically, we would expect broadband and 5G fiber network expansion and electrical grid updates to drive demand for our TRUVAC line of safe digging trucks, which allow for safe access to underground utilities and provide for limited disruption from directional drilling and fiber insertion. In addition, upgrades and expansion of clean water systems would increase utilization of our sewer cleaners as new waste stations and pipe upgrades would require cleaning.

Following the 2019 acquisition of Mark Rite Lines Equipment, our product offerings also include road marking and line removal equipment, and we provide road marking services. We would expect our MRL products and service offerings to benefit from the more than \$300 billion earmarked for road resurfacing and repair work, which could also lead to increased demand for our street sweeper products.

Further, our dump truck body and trailer products are utilized, commercial housing and road construction, which much of the products outlined in legislation, resulting in an increased need to haul asphalt, dirt, gravel and other material.

In addition to demand for new equipment, we would expect to see increased demand for our aftermarket businesses through increased parts and services, used equipment and rental activity. We will continue to monitor any additional development.

Finally, our strong balance sheet will continue to provide opportunities for us to drive both our organic growth initiatives and M&A. Our strong cash flow generation, low debt levels and strong financial position will help us to navigate through the ongoing challenges presented by the pandemic. At the same time, we remain committed to our long-term capital allocation priorities of investing in organic growth initiatives and funding cash return to shareholders. With our strong cash position, the available financing under our revolver and our conservative leverage, we are confident in our ability to continue to not only fund our existing operations, but also pursue strategic transactions and participate in an M&A environment with more reasonable valuation expectations than existed in the pre-COVID world.

To illustrate that, during the quarter, we completed the acquisition of PWE, a distributor of maintenance and infrastructure equipment covering North Carolina, South Carolina and parts of Tennessee. PWE has been a long-term partner of Federal Signal, and this transition facilitated orderly ownership transition in an attractive geographic market for approximately \$6 million. The acquisition added a third location to our current footprint in this population-dense region, which will allow us to better serve our customers and accelerate the growth of our aftermarket business.

In general, we see M&A markets starting to open again with more deals flowing through. Although the pandemic may create some logistical challenges, we are now more optimistic in our ability to get the deals done than we were 90 days ago.

We are also in a position to be opportunistic as it relates to acquiring certain manufacturing facilities that we currently lease. For example, we recently executed a letter of intent to acquire one of our dump truck manufacturing facilities at a very attractive valuation. We also secured a parcel of adjacent land. Both will facilitate the expansion of our footprint to support a strategic growth initiative to broaden our access to end markets and to allow us to better support our customers.

There remains an amount of uncertainty surrounding the potential business impacts from COVID-19, and we, unfortunately, are not immune to the effects of the pandemic. While we have been proactive in our approach, as I just mentioned, the pandemic continues to create ongoing challenges in running our

operations at normal levels. With the recent increase in cases across many states in which we operate, it is possible that we may continue to experience elevated employee absentee levels in the second half of the year. We are committed to taking the necessary steps to minimize disruption with the objective of achieving more normal production levels.

As a reminder, we started the year strong with our first quarter earnings up 30% on a year-over-year basis. In recent years, our second quarter earnings have represented the strongest of the year, in part due to the prevalence of annual activities that typically occur during the quarter. Due to pandemic, many of these activities, which include industrial plant shutdowns, rental activity and spring cleanups, were either significantly curtailed or canceled and are not expected to be rescheduled until next year. Our backlog remains at a healthy level, providing us with visibility into the second half of the year. Assuming that we do not experience any significant COVID-related disruptions for the duration of the year, we currently expect our adjusted EPS for 2020 to be in the range of \$1.53 to \$1.65.

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

Operator

Thank you. We will now 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. One moment, please, while we poll for your questions.

Our first questions come from the line of Steve Barger of KeyBanc Capital Markets. Please proceed with your question.

Steve Barger

Thanks, good morning.

Jennifer Sherman

Good morning, Steve.

Steve Barger

It's really good to hear about the sequential improvement as the quarter progressed. Now normally, 3Q revenue steps down from 2Q, does the 17% decline this quarter break that pattern, meaning that we should think 3Q revenue is up sequentially?

Ian Hudson

Yes. I think, Steve, as we mentioned, April was the lowest of the—in terms of the average weekly revenues that we had in April, it was the low point, and then it's improved sequentially each month since then. I think with that said, and with the caveats about no additional disruption from any COVID-related incidents, I think we would expect to see that continue into the third quarter. Yes, I think we're expecting that trend to continue. The Q3 would be expected to be higher than Q2, just given that April was low.

Steve Barger

Yes. Understandable. That suggests Q half revenue should come in above the \$556 million in the first half, I would think. Is that fair?

Ian Hudson

Yes, with the same caveats, yes.

Steve Barger

The caveats, yes. The reason I ask is, at the midpoint of the EPS guide, you'd put up \$0.78 in the back half versus \$0.81 in the front half. So if revenue is expected to be up, presumably, that means you would come in towards the higher end of the guidance range, all else being equal? Or is there something in there that would avoid ...

Jennifer Sherman

That's clearly our objective. What we tried to factor into the guidance was a certain number of days that we might experience disruption related to COVID. That's why the range is a little bit wider than you typically see. We're clearly targeting the higher end of that range, but we wanted to make sure certain things are outside of our control, and we're going to do the right things by our employees. We factored in a certain number of COVID disruption days, and we're hoping they are fewer rather than more.

Ian Hudson

Yes. I think, Steve, I think the outlook that we gave kind of indicates or implies that we're expecting to be operating towards the high end of our target EBITDA range for the year. I think Jennifer mentioned in the prepared remarks, we are—from a cost savings standpoint, we did bring back employees so that we're expecting the cost savings in the second half of the year to be basically the equivalent of the amount we saved in Q2. We are still committed to investing in new product development because we think we're in a position to continue to invest for the future. That's going to remain—some of those costs will be added in the second half of the year. That may create a little bit of margin pressure when you compare it to the strength of the Q2 margin performance.

Steve Barger

Yes. Yes, to that point, if my model is right, this was the best SSG margin in the segment's history, despite a 2% decline in revenue. Can you talk through what drove that specifically? Should we be thinking that's sustainable at 19%-plus?

Jennifer Sherman

Yes. I think a couple of things here. One is, we acted very quickly and decisively in terms of adjusting our production to respond to the pandemic. We instituted staggered shifts at SSG in order to meet the requirements of safe distancing. That worked out pretty well. Mix played an important factor in that. But again, Mark Weber is running that business, and Mark and the team are doing a super job in terms of their continuous improvement activities. It's going to vary quarter-to-quarter, but they did a fantastic job in some pretty challenging situation of achieving that margin level.

Steve Barger

Yes. That's why I ask. I mean, if you staggered production or reduced production, you would think you would have absorption issues. Yet you were able to put up the best margin in the segment's history. Was that primarily mix that drove that? Is that a mix that we can expect in the back half?

Ian Hudson

Yes, there was some mix aspects to the—probably the largest was within our European business. We had a very large contract that shipped during the quarter. I think some of that is also a factor in the orders. When SSG, we've talked about the orders, they're not necessarily as indicative as they are on ESG because you can receive the order and ship it in the same quarter. But we had a large order that we received in Q1 that shipped in Q2. That was really, from a timing standpoint, that was really accelerated in the first quarter. I think even when you look at the order drop that we saw in Q2, a lot of that was timing related because of when we received this order. That shipped, it was predominantly in May and June, most of that shipped. That was a favorable margin shipment. There is definitely some mix aspects, and most of it was within our European business.

Steve Barger

Understood. Thanks, I'll get back in line.

Jennifer Sherman

Thank you.

Operator

Thank you. Our next question has come from the line of Mike Shlisky from Colliers Securities.

Jennifer Sherman

Morning, Mike

Mike Shlisky

Good morning, guys. Hey, good morning, guys, how are we doing?

Jennifer Sherman

Good.

Mike Shlisky

Good. I just want to follow-up on those last few questions there. I mean, this past quarter was potentially your worst quarter during the pandemic from a top line perspective, yet the margins certainly delivered here. Have you given any thought to making some upside changes to your long-term margin targets for each of the segments now that you passed this test with flying colors here?

Jennifer Sherman

Yes. We're not going to make changes this quarter, given the uncertainties of the pandemic. But we are absolutely—we'll make changes if we can sustain this on an ongoing basis. We have adjusted our margin targets upward, both at ESG and at SSG over the last couple of years. We'll continue to take a look at it.

We just want to confirm that it's sustainable through these challenging market conditions but it's something that we're very focused on. As I've mentioned before, it is a component of our short-term incentive bonus program. There's an incentive across our organization regarding improvement of the EBITDA margin.

Mike Shlisky

Okay. Great. Looking at the back half outlook here, I also wanted to ask a question for just a little bit more color. I guess, which categories do you feel best about in each of the segments for the back half of the year? Which ones are you the most cautious on? Are there any differences between, let's say, street sweepers and vacuum trucks, etc.?

Jennifer Sherman

As I look at the second half of the year, we talked about on the call, our TBEI businesses, SSG, our aftermarket business evolved, proved to be pretty resilient. Our TBEI business bounced back the quickest. We're encouraged by what we're seeing there. I'm also encouraged by the order trends for our Vactor business in July. We saw improvements versus June in both sewer cleaners and our safe digging equipment. Street sweepers have been pretty steady. I think that's the best way to describe it. Off the April lows, we've seen some improvements. Then MRL, our acquisition, particularly the HighMark, the services part of it, has done really well.

I think, as I look forward, one of the things that gave us confidence in order to reinstate guidance was the improvements that we were seeing across the board. We need to continue to see chassis deliveries occur. That's important. It does have a little bit of knock-on effect for our SSG business. But we're going to continue to invest in new product development, that's been important. We have leading market positions. I believe that as we come out of this pandemic that we will gain market share. I'm encouraged by what we're seeing longer term in the market.

Mike Shlisky

Got it, thanks. That's great color. I also want to ask, Ian, some of your comments about the pension charges in the quarter. You had mentioned you had exited a multiemployer plan. Yet, I didn't see any increase in the pension liability on your balance sheet from the previous quarter. I'm no pension expert. I just want to make sure, is that something we should be seeing in the future, some increase in your balance sheet expectations for your pension? Or are there any other things we should be watching for that cash flow on that line or in that part of your business?

Ian Hudson

Yes, you probably—Mike, you probably won't see it on the pension line item in—on our balance sheet, where you'll see it is it's a component within our current liabilities. You'll see it in the current liabilities, that will be a component that we will—and we currently expect to pay it in the second half of the year. It will be in and out within the year because we'll expect to pay that withdrawal liability during the second half of the year.

Mike Shlisky

Okay. Is that a high dollar amount or... ?

Ian Hudson

It's a \$2.5 million charge that we recognized. That's the best...

Mike Shlisky

Oh, so that's in dollar amount.

Ian Hudson

Yes. We charge that.

Mike Shlisky

Okay, got it. Perfect. Wait, that makes sense. Thanks so much, guys, I'll hop back in queue. I appreciate it.

Jennifer Sherman

Thank you, Mike.

Operator

Thank you. Our next questions come from the line of Walter Liptak of Seaport Global. Please proceed with your question.

Jennifer Sherman

Good morning, Walt.

Walter Liptak

Morning, great quarter, guys. I wanted to ask about just the order trends. The declines in the second quarter year-over-year were pretty steep. It sounds like the orders are coming back nicely in June. I'm wondering, do you think you'd be able to get back to prior run rates? Or has something changed about the end markets as a result of the virus and recession that we just went through?

Jennifer Sherman

Yes. A couple of comments. First of all, we expect Q3 orders, based on what we're seeing today, to be better than Q2 orders. From a trend standpoint, it's moving in that direction. In my prepared remarks, a couple of things to note versus Q3 last year as we had the acquired backlog of MRL, which was about \$27 million. That, you need to deduct that. We also had a very strong quarter.

But I am encouraged by what I'm seeing. We expect Q3 orders to be better than Q2. With respect to our end market, again, I believe that we're in a very good position right now because we have leading brands. We're investing in new product development, and we've got some nice successes there. In our TBEI businesses, for example, they introduced a new product at the end of the first quarter, their Dura-Tuff product, and they crossed \$1 million in a couple of months in a very difficult quarter. That's something where I believe longer term, we'll—we don't see any changes. In fact, if anything, we see opportunities to gain market share.

Walter Liptak

Okay. Great. I wonder, specifically about some of the TRUVAC spending and the utilities. What we're hearing is that the utility cap ex budgets are still intact, and they're still spending. What are you seeing from your utility customers?

Jennifer Sherman

Yes. April and May were tough because things were shut down. As I talked about on the call, we saw a sea change in June to the positive. We did double the number of demonstrations, which are very important for the sale of that product than we did in May and June—I mean, April and May combined. They're also more than we did in June of last year. We are encouraged by that. In addition to that, Safe Digging products so far in July are up versus June.

Again, the trends are going in the right direction. We've seen some good interest in some of our new product introductions, specifically the Coyote. As we move forward, that's an important growth area for us that we'll continue to invest in. I think the other thing that's important to understand is the market conditions, longer term, I believe, in safe digging will be more favorable for us because some of the Western Canadian smaller companies that were very dependent on oil and gas are struggling.

Walter Liptak

Okay. Got it. Then last one for me. The profits look great, but the free cash flow looks very good as well. Have you provided or can you give us an idea of the 2020 free cash flow that you think you might be able to generate?

Ian Hudson

Yes. I think, Walt, we aim for kind of cash conversion on a net income basis of about 100%. We continue to think that will be the case this year. In terms of cap ex, I think we're looking at between \$30 million to \$35 million of cap ex this year. That's a tick higher than what we talked about last quarter. A lot of that is really related to some of the things that Jennifer mentioned about some opportunities we have to purchase some of our leased facilities at pretty attractive rates. Those are some of the things that we're looking at, and that might cause our cap ex to tick up a little bit.

Walter Liptak

Okay. Mentioning cap ex, how are things going with Streator? Or are you close to finishing that project?

Jennifer Sherman

Yes. Great question. We had paused the construction during March and April due to the pandemic. We've reinitiated the project. We're on track to complete a major portion of it by the end of the third quarter, the final portion by the end of the fourth quarter. What's been great is we've been able to move into some of that space, and it's really helped us with the safe distancing requirements in place in Illinois and been a true benefit, so we're encouraged by the progress that we're seeing.

In addition to that, as I talked about on the call, we had other projects that are continuing. Rugby facility, our MRL facility. As I talked about, we've signed a letter of intent to acquire a facility up in Minnesota at attractive valuation. Good work being done there, which longer term will both support our growth, support some M&A and also some improvement with respect to productivity.

Walter Liptak

Okay, great. Great quarter, guys. Thanks.

Jennifer Sherman

Thank you, Walt.

Operator

Thank you. Our next questions come from the line of Chris Moore of CJS Securities. Please proceed with your question.

Chris Moore

Hey, good morning, guys.

Jennifer Sherman

Good morning, Chris.

Chris Moore

Good morning, impressive quarter.

Jennifer Sherman

Thank you.

Chris Moore

Sure. I just want to make sure I understand the \$14 million in cost savings in Q2. Is that all temporary? Is some of it permanent? I'm trying to understand if the cost structure will be meaningfully different pre-COVID versus post-COVID?

Ian Hudson

Yes. Chris, I think the first thing we would say is that, that is our plan for the year. Our plan for the year, we were—clearly, we were set up for another record year at the beginning of the year. That obviously didn't turn out to be the case with the pandemic. The \$14 million was really versus the plan that we had for the second quarter. As we look out to the second half of the year, we think we'll be at a similar level of savings versus the plan for the second half of the year. Roughly evenly split, \$7-ish million in each of Q3 and Q4. About half of it is coming back—would be coming back. Things like we had—obviously, travel and entertainment was—that was significantly down in Q2.

As we're seeing some of those things free up a little bit, we're seeing a little bit more travel. We're getting—our sales teams are getting back out on the road now that some of the stay-at-home restrictions have lifted. Some T&E will tick back up again. We had temporary furloughs of employees. That's probably the biggest driver of the \$14 million savings. Many of those have returned as we've picked back up on production levels. But unfortunately, as Jennifer mentioned, we did execute a reduction in force. That did result in some eliminations of positions.

Chris Moore

Got it. That's helpful. Just when you look at the competitive landscape post COVID, and Jennifer started to touch on this a moment ago, suggested that you guys should enjoy improved positioning, especially with respect to smaller players. On the Safe Digging side, Western Canada, sounds like they're smaller oil and gas focused. Are there other logical areas where you just—you may be in a better position competitively?

Jennifer Sherman

Another good example would be some of our TBEI businesses where there's some smaller competitors. There are other examples, but that would be the other area.

Ian Hudson

Those, Chris, typically, they may be in different geographies from where we currently are. That would be different regional players. That business is a regional business. Those would be the types of business.

Chris Moore

Got it. All right, I'll jump back in line. Appreciate it, guys.

Operator

Thank you. Our next questions come from the line of Greg Burns of Sidoti & Company. Please proceed with your questions.

Jennifer Sherman

Good morning, Greg.

Greg Burns

When we look at your backlog, have you seen any major project cancellations or delays, either on the municipal or industrial side of the business?

Jennifer Sherman

No, not at all.

Greg Burns

Okay. When we look at the municipal side, you outlined the diversity of the revenue streams there. But have the conversations with the customers changed there? Are they pulling back on projects or orders? Or have you seen any change given all the—what we're seeing in a lot of the major municipal markets around the country, either from COVID or more recently with some of the other protesting and things like that?

Jennifer Sherman

Yes. To date, we have—outside the pandemic impact, we haven't seen impact from those discussions. It's something we're monitoring closely. We wanted to give you all some additional data about the nature and the specifics regarding our businesses in the various public funding sources. With respect to some of the discussions around our Public Safety Systems business, we have diversified that business quite a bit.

Our export business to Latin America has increased. We have a portion of that business that's in Europe. Some of it is immune from the discussions that are going on right now in the states, another portion of it's in Canada. We would expect right now that new police car registrations could be down 10% to 15% next year. But as we move forward, that only represents a portion of our business. It's something we're monitoring closely, but we believe given the funding sources that, for many of our products, like water taxes for sewer cleaners, will be somewhat insulated from any impact.

The other thing I think is important, too, is the nature of our products, they clean. Right now, there's a premium placed on cleaning.

Greg Burns

Okay. I guess that leads me to the last question. The fedsigresponse, have you seen any traction with that initiative, repurposing some of your equipment or highlighting the utility of your equipment for cleaning and sanitation purposes?

Jennifer Sherman

Yes. Right now, the interest is very high. We've had over 4 million hits on our fedsigresponse. We're in the process of demonstrating it. There's a great demo video on our website, fedsigresponse, but we're in very early days right now to offer any conclusive data regarding the take rate.

Greg Burns

Okay, thank you.

Operator

Thank you. Our next questions come from the line of Marco Rodriguez of Stonegate Capital Markets. Please proceed with your question.

Marco Rodriguez

Good morning, guys, thank you for taking my questions.

Jennifer Sherman

Absolutely, good morning.

Marco Rodriguez

Morning. I was wondering if maybe you could talk a little bit about some of the strategic initiatives that you had discussed in the last call, you've obviously hit on here. Specifically, actually, the market share gains, you made mention of it multiple times that longer term, you are expecting market share gains, especially versus some regional competitors. Just wondered if maybe it's a little bit too early just yet, but have you seen any sort of movement there where you can really point to the fact that you are gaining share from some of the regional competitors?

Jennifer Sherman

We're in early days. We've got some anecdotal evidence regarding some accounts that have been—different orders have been placed with us versus our competition. But let me go back a minute to the

investments that we're making because I think they're important and they will differentiate us from the competition going forward. Our Reclaiming Tomorrow, Together initiative, one focus is on our digital customer experience. That's been an area that we've really accelerated throughout the pandemic in terms of creation of materials and videos for our salespeople, everything from training videos to marketing videos. I think that's something, as we move forward, our customers will value.

Second, we continue to invest in new product development. Probably a great example is electrification of our—some of our street sweeping products. It's an expensive undertaking. We've been working on it for quite some time. We're going to continue to work on it. We've had some positive demos out west. That, again, is a good example of an initiative that we believe, longer term, customers will value and will differentiate us from the competition because, candidly, it's pretty complex, and it costs a lot of money. It's those types of things that we believe will allow us to take leapfrog ahead.

The other thing we're very focused on is reducing lead times for our sewer cleaner and our safe digging businesses. As we talked about pre-COVID, it was a problem for us. They're too long. We've been making good progress on that, particularly as we continue with finishing the plant expansion down at Vactor. We're going to be in a really good position as we go into 2021 with reduced lead times that will allow us to both benefit from any infrastructure bill, and we think take share from the competition.

Marco Rodriguez

All right. That's helpful. Then following up on the comment that you were talking about in terms of supply chains, if you will. I know the last quarter there was some potential for supply chain issues or disruptions domestically. It doesn't sound like you saw too much or that it rather improved as the stay-at-home orders opened up. But can you talk a little bit about your expectations for supply chain domestically here for the second half of the year?

Jennifer Sherman

Sure. We had some challenges with some parts at some of our businesses in March and April. The teams did a super job working through those. Probably the most significant issues we talked about was in our TBEI business with the chassis. We were at a low point of two per day at one of our facilities. It's improving. It went back up to eight, and we've seen further improvement in July. I feel pretty good about where we are with that. But in general, as we sit here today, assuming no additional shutdowns, we don't expect any supply chain disruptions from the second half of the year.

Marco Rodriguez

Got it. It was very helpful for you to put out the revenue diversification on the municipalities on their budgets, very useful information. But I was also wondering if you can maybe talk a bit about your dealer/distributor channels. Are you seeing any sort of stress there as it relates to their ability to access capital?

Jennifer Sherman

No. Our teams do a really good job of staying in contact with our dealers. Mark Weber, our COO, and myself, I've spoken to many of our large dealers between the two of us. Many of them have very strong balance sheets, continuing to invest. I really think it's an asset of Federal Signal and something that differentiates us from the competition. We've had no real collection issues. Our cash flow is demonstrated by the second quarter, continues to remain strong. We're very fortunate to have the dealer partners that we do.

Marco Rodriguez

Got it. Last quick question. Just looking at the cash flows from operations in the quarter and the activities around working capital. Just wondering, as we look at the second half of the year, were there any one-off type situations that you implemented in the quarter to help working capital that will unwind in the second half of the year? Or are there some permanent things that you were able to improve working capital management for you guys?

Ian Hudson

Yes. There was a number of temporary things that we did, Marco, that at some point in the future will unwind. There were also some things as it relates to the CARES Act that allowed us to defer some certain payments. For example, I think there was about \$3.5 million of income tax payments that we deferred from Q2 into Q3. There were also some deferrals of some payroll taxes that the CARES Act allows. Those are more longer-term deferrals; I think you can pay 50% in 2021 and the other 50% in 2022. At the end of Q2, that was about \$2.5 million. That would be—we would expect that to continue. But those are some of the temporary things that were resulting from the CARES Act provision.

The other things that really drove the cash flow were lower rental fleet investment. I think that's one of the things we're in a favorable position for being both the manufacturer of the equipment and also having the direct contact with the customers as it relates to utilization levels so that if we see any downturn in utilizations levels, we can scale back on what we're adding to the fleet. That was certainly a factor during this quarter in comparison to Q2 of last year when we were probably adding more units to the fleet.

Marco Rodriguez

Got it, thanks a lot for your time, guys. I appreciate it.

Operator

Thank you. Our next questions come from the line of Steve Barger of KeyBanc Capital Markets. Please proceed with your questions.

Steve Barger

Hey, thanks for letting me jump back in.

Jennifer Sherman

Absolutely.

Steve Barger

Ian, first, just a modeling question. The \$33 million SG&A in the quarter was the lowest since early 2017 when the revenue base was a good bit higher. I think you said you expect a \$14 million in savings in 2Q to be—that amount to be spread across 3Q and 4Q. Does that mean we're thinking SG&A on a dollar basis will run back towards the high \$30 million range in the back half?

Ian Hudson

Steve, just on your SG&A. I think you said \$33 million. I think we're looking at more like \$37 million. I think that's what we have for Q2. I just wanted to make sure.

Steve Barger

With a bunch of add backs or deductions for the COVID expense and integration and restructuring, right?

Ian Hudson

Adjusted. Okay. Yes, I think when we look at it as a percentage of sales, that's typically how we approach our SG&A. It's been in \$12.5 million to \$13.5 million range over the last several quarters. I think we will adjust, as we've demonstrated in Q2, I think we've—we'll remain flexible. There are things that flow through the SG&A line that can be a little unpredictable. Things like, we have a mark-to-market liability. I think we've talked about that previously. That sometimes flows through. That can cause some volatility. But the most part, we're going to target a similar SG&A as a percentage of sales as we've had in the last several quarters.

Steve Barger

Okay. Jennifer, you spent a lot of time in your prepared comments talking about all the catalysts that could come from an infrastructure bill, which I think—which I agree with. But how are you handicapping that actually getting signed into law?

Jennifer Sherman

Historically at Federal Signal, I've discouraged our businesses from ever including an infrastructure bill as part of their annual operating plan because my own belief has been that it wasn't going to happen. I think—so we've taken an approach. This is not something that this is new for us to say, “Okay, how do we plan and what do we do?” Look, I don't know any more than everybody else does. We monitor it closely. My personal belief is as we—both sides of the party, we're a pretty divided country right now, and this seems to be an area where there's commonality. I think it's an economic stimulus for the country. As we come out of the election, I think that there's a better probability than I've ever thought before that an infrastructure bill will be passed.

Steve Barger

Interesting. Okay. Then the PWE comments, I may have missed this, but why wouldn't that be a better fit for one of the dealers?

Jennifer Sherman

Just given the dynamics of that particular territory, we believe that right now the JJE team is the best entity to work with the local team in terms of rebuilding that territory. We think there's a lot of opportunity there. We made the decision with the owner as part of his succession process that Federal Signal and particularly the JJE team was best positioned to help grow that business.

Steve Barger

Is there a lot of overlap in that region with existing dealers?

Jennifer Sherman

No, it's exclusive.

Steve Barger

Okay. This is not a situation where you're necessarily competing with your own channel?

Jennifer Sherman

Correct. It's exclusive on the municipal side of things.

Steve Barger

Okay, thank you.

Jennifer Sherman

Absolutely

Operator

There are no further questions at this time. I would like to turn the floor back over to Jennifer Sherman for any closing remarks.

Jennifer Sherman

There's no denying these are uncertain times. This experience has confirmed my strong belief that our workforce is unparalleled in its passion, commitment and grit, and while we may have some challenging days or periods, I'm confident that we will band together and work through these challenges as we have many others. We are nimble and will continue to move quickly. 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, an experienced team with a proven track record of anticipating issues and proactively implementing responses. The coronavirus has not changed any of these factors. I am optimistic about the long-term future of our Company.

I would like to thank our shareholders, employees, distributors, dealers and customers for their continued support. Thank you for joining us today. Be safe, and we'll talk to you soon.

Operator

This does conclude today's teleconference. You may disconnect your lines at this time. Thank you for your participation and have a great day.