



Federal Signal Corporation
Third 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 Federal Signal Corporation's Third Quarter 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 call please press star, zero on your telephone keypad. Please note this conference is being recorded.

I would now like to turn the conference over to your host, Ian Hudson, Chief Financial Officer. Thank you. You may begin.

Ian Hudson

Good morning, and welcome to Federal Signal's Third 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 will refer to some presentation slides today, as well as to the earnings 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 we begin, 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 earnings 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.

I'm going to begin today by providing some detail on our third quarter results before turning the call over to Jennifer to provide her perspective on our performance and our outlook for the remainder of this year. After our prepared comments, Jennifer and I will address your questions.

Our consolidated third quarter financial results are provided in today's earnings release. In summary, despite challenging circumstances, our teams continue to execute at a very high level, again delivering an Adjusted EBITDA margin in excess of our target range and generating further positive cash flow.

Consolidated net sales for the quarter were \$280 million compared to \$309 million last year. Consolidated operating income in Q3 this year was \$34 million compared to \$38.6 million last year. On an adjusted basis, consolidated operating margin in Q3 this year was 12.4% compared to 12.7% last year. Consolidated Adjusted EBITDA for the quarter was \$45.9 million compared to \$49.8 million in Q3 last year. That translates to a margin of 16.4% in Q3 this year compared to 16.1% last year.

Net income in Q3 this year was \$25.3 million compared to \$28.4 million last year. That equates to GAAP EPS of \$0.41 per share compared to \$0.46 per share last year. On an adjusted basis, EPS for Q3 this year was \$0.42 per share compared to \$0.47 per share last year.

Orders in Q3 this year were \$266 million, up \$65 million or 32% from Q2 of this year. Our backlog at the end of the quarter remained healthy at \$320 million.

In terms of our third quarter group results, ESG sales were \$231 million compared to \$254 million last year. ESG's Adjusted EBITDA for the quarter was \$43.9 million compared to \$46 million a year ago. That translates to an Adjusted EBITDA margin of 19% in Q3 this year, above our target range and up 90 basis points from last year.

SSG's third quarter sales were \$49 million this year compared to \$55 million last year. SSG's Adjusted EBITDA for the quarter was \$8.2 million compared to \$9.4 million a year ago. And SSG's (audio interference) for this year was 16.8% compared to 17.2% last year.

Corporate operating expenses in Q3 this year were \$6.4 million compared to \$5.9 million last year.

Turning now to the consolidated income statement.

Gross margin in Q3 this year was 25.9% compared to 26.6% last year. Our results in Q3 this year included the recognition of approximately \$2 million of excess overhead costs that flow through the income statement as inventory period costs due to lower production levels.

As a percentage of sales, our selling, engineering, general and administrative expenses for the quarter were down 20 basis points from Q3 last year.

Other items affecting the quarterly results include a \$200,000 decrease in acquisition-related expenses, a \$300,000 increase in other income, and a \$900,000 reduction in interest expense largely due to lower average interest rates in comparison to the prior year.

Tax expense in Q3 this year was down \$300,000 compared to the prior year, largely due to lower pretax income levels and the recognition of a \$1.3 million excess tax benefit from stock compensation activity. This tax benefit added approximately \$0.02 to our third quarter EPS and led to our effective tax rate for the quarter being lower than expected at around 23%. At this time, and assuming no additional discrete tax benefits, we expect our full year effective tax rate to be approximately 24%.

On an overall GAAP basis, we therefore earned \$0.41 per share in Q3 this year compared with \$0.46 per share in Q3 last year.

To facilitate earnings comparisons, we typically adjust our GAAP earnings per share for unusual items recorded in the current or prior 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 third quarter were \$0.42 per share compared with \$0.47 per share in Q3 last year.

Looking now at cash flow, where we generated \$15 million of cash from operations in Q3 this year, bringing the total amount of year-to-date operating cash generation to almost \$80 million. That represents improvement of \$21 million or 36% compared to the prior year period.

Overall, our capital expenditures so far this year have totaled approximately \$24 million, up from \$21 million last year. For the full year, we are currently expecting total Capex of between \$30 million and \$35 million. Jennifer will provide some additional detail on some of these investments shortly.

We ended the quarter with \$173 million of net debt and current availability of \$251 million under our credit facility. As a reminder, we executed a new five-year \$500 million credit facility last July. We also have the option to trigger an increase in our borrowing capacity by an additional \$250 million for acquisitions. Our net debt leverage ratio remains low and essentially unchanged from year-end.

Cash flow so far in October has met expectations with no material change in customer delinquencies or bad debts.

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 inorganic growth initiatives, pursuing strategic acquisitions and funding cash returns to shareholders.

On that note, we paid a dividend of \$0.08 per share during the third quarter amounting to \$4.8 million, and we recently announced a similar dividend for the fourth quarter. During the quarter, we also spent \$200,000 buying back shares. We currently have about \$91 million of authorization remaining under our stock repurchase programs.

That concludes my comments. 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 ongoing commitment. I am immensely proud of how our teams have managed through these challenging times. Since the outbreak of the pandemic, a critical area of focus has been on the health and safety of our employees.

We have implemented a host of 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 invested in temperature screening capabilities at most of our facilities, issued a mandatory face mask policy, provided our employees with additional paid time-off, and made at-home coronavirus testing kits available for free to our employees and their family members.

Concurrent with similar trends in many states across the United States, we have unfortunately experienced a recent uptick in the number of confirmed cases within our employee base. Nearly all of those cases appear to have originated from outside of the workplace. Our teams continue to do a fine job navigating through the COVID-related disruptions and protecting our employees at our facilities by adhering to our safety protocol.

Four years ago, we began a transformational journey aimed at reducing the cyclicity of our businesses. Through a combination of organic initiatives and strategic acquisitions, we have diversified our revenue streams and our end markets, and in some cases, deliberately identified new sources of revenue that were countercyclical to our legacy Federal Signal businesses. Primarily through the acquisitions of JJE in 2016 and HighMark last year, we have been successful in expanding our product offerings to include rentals, used equipment, parts and service.

In addition, with the acquisitions of TBEI in 2017 and MRL last year, combined with our new product development efforts, we have added new end markets such as construction, infrastructure and utility. On the organic side, we have entered the utility end market with a broad product offering of safe digging equipment.

We have also benefited from the ongoing application of our 80/20 principles and have worked to develop robust contingency tools to invoke as needed. These strategic decisions have resulted in tremendous benefits so far this year as we continue to operate at a very high level in these unprecedented times.

The strong results that we were able to deliver and the excellent operational execution that our teams have demonstrated in challenging circumstances were a testament to the strategy, the quality of our businesses, our experienced leadership teams, the commitment of our employees and the agility of our team.

Our third quarter order intake was up \$65 million or 32% compared to the second quarter, further evidencing our strong business fundamentals, broad range of product offerings and diversity in our end markets. Overall, our operating results for the quarter were in line with the high expectations that we had entering July. As we have previously discussed, the second and third quarters are seasonally strong periods for many of our businesses, and in particular for TBEI, our dump truck bodies and trailer businesses whose products are frequently used by customers working in construction end markets during the warmer summer months.

Within our specific end markets, much of the sequential improvement resulted from our truck bodies business, where we have seen the quickest recovery. On our last call, we discussed the significant drop-off in orders at the beginning of April, driven in large part by the lack of available customer-supplied chassis at TBEI, with many of the chassis OEMs shut down. We have seen the chassis situation continue to improve. For example, in the third quarter, chassis availability at one of our plants averaged approximately 10 deliveries per day, which is only slightly behind last year and much improved over the low point of approximately two deliveries per day in May.

With those improving conditions and the efforts of our sales teams, TBEI's orders were up \$16 million or 40% sequentially from the second quarter and up \$12 million or 28% year-over-year. During the quarter, TBEI was also able to overcome certain pandemic-related disruptions and deliver its highest quarterly EBITDA margin since we completed the acquisition a little over three years ago. Strong seasonal aftermarket performance also contributed to the impressive third quarter results.

As a reminder, rental activity and parts and service revenues are typically higher in the second and third quarters of the year because many of the Company's product and service offerings are used for maintenance activities in North America, where usage is typically lower during periods of harsher weather conditions. For the quarter, our aftermarket revenues represented approximately 27% of ESG's revenues

for the quarter, which is up from 24% in the prior year period. The strength of our aftermarket business contributed to the strong margin performance and year-over-year improvement during the quarter.

We saw a nice improvement in our rental utilization in Canada with utilization levels for major product lines recovering to pre-COVID levels and exceeding our target levels by the end of the quarter. Our U.S. rental fleet also experienced sequential monthly improvement utilization although at a slower rate than in Canada. These factors contributed to a 13% sequential quarterly increase in aftermarket revenues, essentially recovering to levels that were achieved in the prior year quarter.

With sales travel slowly resuming, we are also able to increase the amount of equipment demonstrations performed during the quarter. As an example, we were able to complete 330 demonstrations and presentations of our TRUVAC branded products in Q3 this year. That represented a 76% increase from the amount performed in the second quarter and also exceeded the amount performed in the prior year period.

Once again, we delivered margin performance above the upper end of our target range, achieving an Adjusted EBITDA margin of 16.4%, which included the impact of certain cost-saving actions that we implemented in response to the pandemic.

Through the first 9 months of the year, we have operated above the high end of our target range, underlining the flexibility and responsiveness that are inherent in our 80/20 operating principles. Given the strong margin performance in these difficult times, we are considering raising our margin targets once we get past the ongoing uncertainty related to the pandemic.

While managing through this difficult quarter, we emphasize a continued focus on our long-term growth objectives by investing for the future growth of the Company.

First, we are continuing to make significant investments in our existing plants to add additional capacity to support our long-term growth and to gain operational efficiencies through the use of newer machinery and equipment. We continue to make progress on our plant expansions at Vactor, Rugby and MRL. And during the quarter, we also purchased our TBEI manufacturing facility and additional property in Lake Crystal, Minnesota. With the purchase of the building and property, we expect to increase capacity and gain operating efficiencies to better serve customers in new and existing markets.

One such example of this further market diversification and significant organic growth opportunity is in the expansion of our military business. In partnership with Oshkosh Defense and MAC Defense, we have recently been awarded two contracts to supply dump bodies to the military. Over the multiyear terms of the contract, these awards have the potential to contribute up to \$30 million of revenue. We are excited by the opportunity to be in a position to support this initiative from our expanded facility to which we expect to have an improved operational layout and enhanced (inaudible) capabilities.

Second, we are also continuing to invest in both new product development and have accelerated the development of our digital customer experience tools that will benefit our customers. Both remain key priorities, and we continue to make meaningful progress in a number of areas. At our Jetstream business, we've recently introduced our new 400-horsepower pump into our rental fleet, which provides an effective way for customers to gain familiarity with our new product introduction. Customer feedback to date has been very positive and utilization levels during the fall shutdown season so far have been high.

In addition, I'm excited to share with you that as part of our digital customer experience strategy, in Q4, we are planning to launch our e-commerce site at SSG. We are expecting that in the upcoming years, our e-commerce platform will become a meaningful tool to reach new customers, provide even stronger support to our existing customers, grow our revenue and capture additional market share.

Current conditions accelerated the need for contactless sales and marketing tools. Our businesses responded swiftly. Within our Safety and Security Systems group, we have introduced several videos highlighting the features and functionality of our products, while within our Environmental Solutions group, we are utilizing digital programs to keep prospects and customers informed and engaged with our brands using social media tools like LinkedIn and Twitter.

Using these tools, we reached approximately 900,000 contacts with a little over 5,000 engagements during the quarter. That level of engagement with our content was about double the standard benchmark for engagement across all industries.

In July this year, with cooperation from many of our dealers, we also launched a website to sell our used equipment inventory. Through this website, customers can purchase used Vactor combination sewer cleaners, catch basin cleaners and our TRUVAC vacuum excavators from us or many of our dealer partners.

I'm also pleased to report that earlier this month, we issued our inaugural long-form sustainability report. I'm incredibly proud of the progress that we've made on our environmental, social and governance initiatives and thrilled to share many of our accomplishments through the issuance of this report. With our commitment to continuous innovation, strong governance and reduced resource consumption, we continue to build and deliver equipment that has beneficial impacts to both the environment and human safety. We are proud to be a company whose products have inherent environmental and social importance. And we hope that our pride is evident upon reading the reports.

We have also recently announced an initiative to improve our corporate social media presence. Many of our businesses are very active on social media. This has inspired our corporate team, and you can now find the Company pages on Instagram and Facebook, both with the @federalsignalcorp handle. We intend to use this platform to increase engagement with all stakeholders, including employees, customers and investors. We will also leverage this channel to showcase our outstanding brands, provide insight into our culture and to also celebrate the trivial along with the significance, all with a little bit of humor and fun.

Finally, the foundation of these growth initiatives is our continued strong cash generation, which, as I mentioned, is significantly up compared to last year.

Turning now to our outlook for the rest of this year.

Our track record of solid execution during these challenging times and the continued strength of our backlog provide us with confidence in the remainder of the year. As a result, we are raising our full year adjusted EPS outlook to a new range of \$1.58 to \$1.66 from the previous range of \$1.53 to \$1.65. The new range would represent the second highest adjusted EPS in our history, surpassed only by the record set last year. While our outlook assumes some level of operational inefficiencies associated with the ongoing coronavirus-related challenges, it does not take into account any significant disruptions through the end of the year.

Looking forward, we remain focused on delivering strong results while continuing to execute on our long-term strategy. Our strong balance sheet will continue to provide opportunities for us to drive both organic growth initiatives and M&A. Over the last several years, we have transformed our end market exposure and implemented a revenue diversification strategy that has enabled us as a company to adjust as needed to market condition, develop strong contingency planning protocols, continue our journey of 80/20 and continue to invest for growth.

We are positioning Federal Signal in a manner in which we fully participate in the post pandemic recovery by increasing capacity within our facilities, reducing lead times to a level where we can better respond to customer needs, investing in new product development and gaining market share.

Like many, we are closely monitoring the outcome of the upcoming election and are optimistic about potential actions that either side may take to stimulate the economy, including potential federal stimulus packages that may be provided at the state or local levels to aid municipalities whose budgets have been impacted by the pandemic, and a potential infrastructure bill.

Within our industrial markets, we continue to be bullish about our long-term prospects with respect to our safe digging initiative and are monitoring further developments on the regulatory front closely. On the M&A front, our strong financial position and history of robust cash flow generation will allow us to pursue strategic acquisitions.

In general, we see M&A markets beginning to open up again with more deals flowing through. Although the pandemic has created some logistical challenges on the M&A front, we are now more optimistic in our ability to get deals done than we were earlier in the year.

With that, we are ready to open the line for questions. Operator?

Operator

At this time 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. One moment please while we poll for questions.

Our first question comes from the line of Chris Moore with CJS Securities. Please proceed with your question.

Christopher Moore

Good morning, guys.

All right. Maybe start on a topic we've talked about many times, kind of the state and muni budgeting process. Trying to understand visibility and the way I was looking at it is kind of a two-step process, say, like the state DOT with a June fiscal year. They outlined their expenditures they're looking to make for the next fiscal year and then they have to figure out how to pay for them. First, is that consistent with what you see? And secondly, I guess I'm trying to understand, do you already have a feel for what their wish list is from an equipment standpoint? And then it's really kind of that follow-up in terms of—from the budgeting side.

Jennifer Sherman

Yes, I'm going to borrow a line from one of our peer companies: it's a good time to be in the cleaning business. Reminding everyone that we are an essential business, and what we've seen in Q2 and Q3 is that although order patterns are more irregular, our equipment is valued by municipalities and state governments. I think the other important thing to remember is that our aftermarket business also provides another source for those municipalities if they need to rent or they want to buy used equipment.

As we talked about in my prepared remarks, it's continuing to—we're very pleased with the performance of that business, and it continues to be a viable alternative. So as a Company, I really believe we're very well positioned, whether you need new equipment, used equipment, rental or parts and service to support the essential equipment that we sell.

Ian Hudson

I think the other thing, Chris, is just the range of different funding mechanisms that we've talked about previously. I think on the second quarter call, we went through kind of those different public funding sources that would be through water taxes for sewer cleaners, cell phone bills for certain of our warning system products. So it's a pretty diverse set of budget; it's not just entirely kind of the general municipal funds that you may expect.

Christopher Moore

Got it. That's helpful. So for argument—go ahead, I'm sorry.

Jennifer Sherman

No, I was going to say—the other thing I was going to say is, for certain of our product lines, particularly within ESG, we talked about kind of that the recovery has been different. For example, in Canada, we've seen our rental rates—rental utilization rates return to pre pandemic levels. So again, we have—the diversification that we've done in terms of end markets has benefited us in 2020, and we expect it to continue to benefit us as we go into 2021.

Christopher Moore

Got it. If we assume for argument sake a stimulus package gets past some time in November, December, is there—will there be much of a lag? Or would that kind of be felt pretty quickly by Federal Signal from in terms of that—again, assuming that state and local funding component is pretty strong?

Jennifer Sherman

Yes. I think one of the things that differentiates us this year is our investment in Capex. Our Capex expenditures are up this year, as Ian noted in his comments. And let me give a little bit more color commentary.

We're a big believer in investing and expanding additional—our existing facilities so we can really improve our margin performance. So throughout this year, we've done plant expansions at Vactor that we've talked about quite a bit; it will be done by the end of this year. Our Rugby facility, MRL. And our Lake Crystal facility; we bought the existing plant during the third quarter and adjacent property. And we did all of that because we believe that we want to be well positioned for any post pandemic recovery.

We're also pursuing new end markets and expanding our presence materially in some of those end markets like military.

We've reduced our lead times: that was very important initiative at Vactor because, frankly, it caused us some problems. So we've made that investment with the objective of being able to quickly respond to customer needs.

I feel like as we go into 2021, whether the recovery comes with a stimulus bill or otherwise, we are very well positioned to respond to that situation.

Ian Hudson

And I think, again, Chris, that's another area where the diversification of our revenue streams helps us, right? It helps us respond quicker to any uptick in demand, either through the utilization of our rental fleet, of our used equipment sales. And in addition to our own rental fleet, our dealer partners also have rental fleets and so that will benefit them.

I think, again, that journey that Jennifer talked about really is having benefits in a number of different areas. And that's another tool that we have in our toolbox to take advantage of this post pandemic recovery.

Christopher Moore

Got it. That's helpful, guys. I will jump back in queue. I appreciate it.

Jennifer Sherman

Thank you.

Operator

Our next question comes from the line of Mike Shlisky with Colliers. Please proceed with your question.

Jacob Parsons

Good morning. This is Jacob Parsons on the call for Mike from Colliers Securities. Sorry for the little one-two mix-up on you guys, but I'll get right to it. I have a question regarding like recent hurricanes within the past year and currently ongoing. Have these hurricanes generated any incremental interest in the vacuum trucks or other equipment? In a very similar sense how like snow plows may be in high demand the year after a heavy snow season. Is there any color you could provide on that?

Jennifer Sherman

Sure. Absolutely. Any type of water cleanup, you can utilize many of our ESG pieces of equipment, most specifically sewer cleaners; in some situations our Guzzler equipment, depending on the need. And this creates an opportunity for our customers. It also can create opportunity for our rental equipment, either through us or our dealer partners. So it's something that we monitor closely.

Jacob Parsons

Okay. Excellent. Also, just—I know you guys talked a little bit about your M&A activity. I'm just kind of looking down the road here. Is there any more updates on kind of M&A? And are you pursuing like a broad range of targets? And are they more kind of tuck-in small deals, or are they looking to be kind of larger deals as a whole?

Jennifer Sherman

I think that our M&A activity has increased over the last couple of months. We've seen the markets open back up. We are always—we have a pretty—we have a defined strategy with respect to our specialty vehicle manufacturer and our audible visual warning device business. But we're really focused on a number of deals, both small and larger, and that's consistent with how we've approached M&A. We believe that M&A, longer term, will continue to be an important part of our growth story. (Multiple speakers). I think the other important part is, and we've got the balance sheet to fund M&A.

Jacob Parsons

All right. Got you. I appreciate it.

Operator

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

Gregory Burns

Good morning.

With regards to your cost structure, obviously you took some actions at the beginning of the pandemic. And your margins have been very strong in the last couple of quarters. So I was just wondering, is there any costs that have been avoided, like incentive compensation or maybe some other things that might be coming back online now that the results have held up pretty well? Like how should we think about your cost structure going into the fourth quarter, maybe relative to where we were in the third quarter and then maybe looking out to '21?

Ian Hudson

Yes, Greg, I think we—I think it was on the last call, we talked about kind of the impact of our cost reduction actions. And again, versus the plan that we had for the year, the actions that we took in Q2 we estimate had a benefit or savings, I would say, of \$14 million versus our plan. In Q3, we—that was more like half of that because we had some of those costs came back mainly headcount related as certain furloughed employees came back. So that was about \$7 million savings in Q3 versus our plan. And that's the similar level to what we'd expect in the fourth quarter with a number of the people back at work and travel picking back up again. So I think that's kind of our view for this year.

As we head back into next year, probably there are a couple of things that may be—medical has been a little lower than expected this year just with the pandemic, people aren't necessarily going to the doctor quite as frequently as they may have in the past. So that may return to more normal levels next year.

And then on the incentive comp front, we are—that would obviously reset based on—it's pretty much tied to the targets that we would have for the year. So when we established the plan for next year, that will reset those targets. So that may be a small headwind. But again, achieving those results will influence the amount of expense we recognize on the incentive comp side.

Again, I think as we've demonstrated this year, the margins and performing within those margin target ranges is really important to us. And all of those actions that we took early in the pandemic were really through the lens of offering within those target ranges. And as Jennifer said, we've consistently demonstrated this year that we can operate at the higher end of the range. Year to date, I think we're at 16.2% which is, we think, is strong performance during a very difficult year.

As Jennifer mentioned, when we have a little bit more resolution on the pandemic here, we're committed to increasing those.

Gregory Burns

Okay. Okay. And then looking at the sequential improvement in ESG orders, I think Jennifer had mentioned some pretty strong sequential improvement out of TBEI. But can you just maybe talk about any other areas or product lines that might be contributing to that sequential improvement? And then, is there any other—is there any areas that might have—are still weak or underperforming?

Ian Hudson

No, it's a good question, Greg. And it was really encouraging that it was almost across the board. Jennifer mentioned the dump bodies and trailers, which were up \$12 million and about 40% sequentially. Sewer cleaners and safe digging trucks collectively were up about \$20 million year—sorry, quarter-over-quarter.

Both of those were in excess of 50% increases. And the JJE business also had some nice wins, some pretty large wins on the refuse truck bids within major municipalities up in Canada.

But there really weren't any major product lines of ours that deteriorated versus Q2, so it was almost across-the-board improvement.

Gregory Burns

Okay. And then just looking into the first part of the fourth quarter, how have order patterns kind of trended out in the third quarter?

Ian Hudson

Yes. So far, so good. They've trended in line with where we were expecting things to be. So yes, no surprises so far through the first period in October here.

Gregory Burns

Okay. And then lastly, you mentioned—Jennifer mentioned, being able to get out on sales calls and do demos. How important are demos to driving demand for your safe digging equipment? And have you seen an uptick in the pipeline? Like how has that impacted the funnel of business on the safe digging side of the business?

Jennifer Sherman

There are three things that we monitor very carefully with respect to safe digging.

One is demos, and we talked about how our demos are up significantly during Q3 versus Q2 of this year and back to pre-pandemic levels, which is encouraging. The second area are trade shows. And that's an area where it gives us a platform to educate a large number of people. And unfortunately, those trade shows are virtual or have been canceled. In most situations, we've been increasing our digital tools to address those customers.

And the third thing that we monitor closely are regulations. We've seen, as we've talked about many times, an increase in the number of states and OSHA that acknowledge safe digging as a preferred practice. There hasn't been—states really haven't been focused on that during the last couple of months.

Our expectation is that we're encouraged by the recovery in demos, and as we go through Q2, we should see that translate in—I mean if we go through 2021, we should see that translate into orders.

Gregory Burns

Okay, great. Thank you.

Operator

Once again if you would like to ask a question please press star, one on your telephone keypad. Once again if you would like to ask a question please press star, one on your telephone keypad.

Our next question comes from the line of Marco Rodriguez with Stonegate Capital Markets. Please proceed with your question.

Marco Rodriguez

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

I was wondering if maybe you guys could talk a little bit more about perhaps the competitive environment. On the last call, you guys had mentioned the potential of you guys kind of taking share from smaller kind of regional competitors. But then also, Jennifer today, you had a very nice comment there about being a good time to be in the cleaning business, which sort of somewhat implies - at least to me, that is - that perhaps the competitive environment is not so great at the moment because there's a lot of business to go around. So maybe if you can talk a little bit about that, and any kind of color you can share would be helpful.

Jennifer Sherman

Sure. We have good strong competitors like many businesses. My comments on the last call were really focused on TBEI businesses where we've seen opportunities to take market share, particularly with their accelerated new product development initiatives, and that's something that—when we bought TBEI in 2017, as we entered 2018. One of the things I think that the Company were pretty good at is organic growth, so we utilized our organic growth NPD processes and put it in place at TBEI. And we're starting to see the benefits of that.

We've also heard anecdotally that during these challenging times, some customers are very concerned about—they want to make sure that the manufacturer is going to be around in three to five years to service this equipment. And obviously we've been around for 100-plus years, and we believe that we're very well positioned to participate in post pandemic growth. And as I talked about earlier on the call, we've—our Capex is up this year because we're continuing to invest in many of our existing facilities to support additional market growth, either through our organic growth initiatives or through M&A.

I think that's all been also enhanced by the acceleration of some of our tools and our digital customer experience toolbox, and that will differentiate us from many of our competitors. And that's going to continue to be a focus as we go forward.

Marco Rodriguez

Got it. Very helpful. And then I was wondering if you guys could talk a little bit more about the—your aftermarket business. Obviously, doing very well here in the quarter and has trended positively for the last few quarters for you guys, I think, and helpful from a margin perspective. I was wondering if—just kind of given the pandemic, if any sort of changes you may have noticed by end customers that might be sort of, I don't know, temporarily squeezed or looking for other venues in which to obtain some cleaning type equipment, if you can provide any kind of color there? And then kind of in the same vein, just wanted an update on the MRL integrations and whether that's all been kind of pushed into your aftermarket structure so far.

Ian Hudson

Sure. I'll take the aftermarket, and then Jennifer will probably talk about the MRL acquisition.

As we talked about on the call, the—from an aftermarket standpoint, Q2 and Q3 tend to be the strongest from the standpoint of aftermarket with much of the work taking place during the warmer summer months. And even in the pandemic in the second quarter, our aftermarket business held up pretty well. And it was—even with that, it was nice to see a 13% improvement sequentially versus a pretty strong Q2, all things considered. So we closely monitor the units that we put into our fleet. We monitor utilization levels very closely.

I think Jennifer mentioned that the rates that we've seen in Canada, in particular, have been really encouraging where we've seen sequential improvement on a monthly basis in both time and financial

utilization of our rental fleet. And we're even back to pre-pandemic levels now with our fleet up in Canada. So that's been really encouraging to see the pace of the recovery.

From a customer and a user perspective, it seems like Canada has recovered a little quicker than U.S. - which has recovered. We're still seeing sequential improvement on a monthly basis, but not at the same rate as what we've seen in Canada. So again, I can only emphasize the importance of the aftermarket business from a strategic standpoint and the fact that it now represents 27% of ESG's revenue for the quarter. You see the benefits that has from a margin standpoint. I think that's one of the factors that we've considered in our comfort level and increasing our margin targets when we get through this pandemic.

Jennifer Sherman

Mark and I were out in Billings at MRL last month. And what I'm really encouraged by is, we always talk about our acquisition playbook: year one is integrating, achieving some of those cost synergies, obviously, getting all the public company stuff right, which our teams have done an excellent job, but as we move forward into year two and year three, excited about some of the new product development opportunities for that business. We've invested in terms of—in their plant and their facilities to optimize layout, so we are looking forward to achieving some of the objectives that we set forth.

And again I would remind you, I think as a Company, our playbook is working. We bought JJE, great team there. We improved the margin performance significantly. TBEI just had their best EBITDA margin performance this past quarter since they've been owned by Federal Signal. And again, with respect to MRL, we're using that same playbook, and I expect to see continued improvement both in terms of growth and in terms of other market opportunities and optimizing that business. So good stuff out there.

Marco Rodriguez

Great. Great to hear. Last quick question for me. Your movement into the military markets with TBEI: just wanted to see if maybe you can provide a little more color there in terms of what that market looks like from a servicing standpoint. Are there any sort of dynamics that are a little bit different from what you're currently used to? And then if you could maybe provide if you do have any sort of total addressable market that might represent.

Jennifer Sherman

Sure. Prior to our ownership of TBEI, this particular business unit had done similar work with the military. They're a very experienced and seasoned team in order to meet the kind of rigid vac (phon) requirements. As we move forward, we are making a number of investments to improve our capabilities. This is an important piece of business. I think what we've right now sized it is over the next several years, it's up to a \$30 million opportunity. And I have all the confidence in the world. The teams are working very closely with our partners, Oshkosh Defense and MAC Defense. And I have every confidence in the world that we will achieve those vacs, and this is an important area of growth for us going forward.

Marco Rodriguez

Got it. And I apologize, one last one quick one. Are the margin profiles in that market similar to your overall margins?

Jennifer Sherman

Within our target EBITDA ranges. Yes.

Marco Rodriguez

All right. Thanks a lot, guys. I really appreciate the time.

Operator

We have reached the end of our question-and-answer session. I would like to turn the call back over to Jennifer Sherman for any closing remarks.

Jennifer Sherman

Thank you very much. There's no doubt that these remain tumultuous and uncertain times. However, 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 ahead, I'm confident that we will band together and work through these challenges as we have many others. Our 80/20 principles allow us to be nimble and flexible to react to changing market conditions, and they will continue to do so.

Our portfolio of businesses include many market-leading brands with solid fundamentals. We are making significant investments to support future growth. 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. I continue to remain confident about the long-term growth prospects of our Company.

In closing, I would like to thank our stockholders, 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 concludes today's teleconference. You may now disconnect your lines. Thank you for your participation, and have a wonderful day.