Federal Signal Corporation

Third Quarter 2019 Earnings Conference Call

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CONFERENCE CALL PARTICIPANTS

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PRESENTATION

Operator:

Greetings. Welcome to the Federal Signal Corporation Third Quarter 2019 Earnings Conference Call. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. If anyone should require Operator assistance during the conference, please press star, zero from your telephone keypad. As a reminder, this conference is being recorded. I would now like to turn the conference over to your host, Mr. Ian Hudson, Chief Financial Officer for Federal Signal Corporation. Thank you, you may begin.

Ian A. Hudson:

Good morning, and welcome to Federal Signal's Third Quarter 2019 Conference Call. I am 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've 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.

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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, our outlook for the remainder of this year, and preliminary thoughts as we head into 2020. After our prepared comments, Jennifer and I will address your questions.

Our consolidated third quarter financial results are provided in today's earnings release. As a reminder, the financial results of the quarter include Mark Rite Lines Equipment, or MRL, which we acquired on July 1 of this year. The results of MRL have been included within our Environmental Solutions Group for the quarter.

Overall, we had another strong quarter with impressive results reflecting double-digit increases in sales, income, and orders. We delivered significant margin expansion and a 31% improvement in adjusted earnings per share.

Consolidated net sales for the quarter were $308.8 million, up $39.4 million or 15% from last year. Consolidated operating income for the quarter was $38.6 million, up $8.2 million or 27%. On an adjusted basis, consolidated operating margin was 12.7%, up from 11.5% in Q3 last year. Consolidated adjusted EBITDA for the quarter was $49.8 million, up $10.1 million or 25% from Q3 last year. That translates to a margin of 16.1% exceeding our target range and up from 14.7% last year.

Net income in Q3 this year was $28.4 million, compared to $21.7 million last year. That equates to GAAP earnings of $0.46 per share, up from $0.36 per share last year. On an adjusted basis EPS for Q3 this year was $0.47 per share, which compares to $0.36 per share last year.

Order intake in Q3 this year continue to be strong with total orders of $329 million, an increase of $61 million or 23% compared to the prior year quarter. We ended the quarter with a consolidated backlog of $367 million, which was up $46 million or 14% compared to last year.

Turning now to our group results, where both of our groups delivered significant year-over-year EBITDA margin improvement. ESG reported third quarter sales of $254 million, up $37.7 million or 17% compared to last year. The revenue growth was largely driven by increases in shipments of safe digging vehicles, dump truck bodies, and street sweepers, as well as a $22.6 million contribution from MRL.

ESG's operating income in Q3 this year was $35.9 million, up $7.6 million or 27% from last year. Adjusted EBITDA for the quarter was $46 million, an improvement of $9.3 million or 25% from a year ago. That translates to an Adjusted EBITDA margin of 18.1% in Q3 this year, above our target range, and at 110 basis points from 17% last year.

ESG's orders in Q3 this year were $270.2 million, up $55.7 million or 26% from last year, with orders from the MRL acquisition accounting for approximately $40 million of that growth. Organically, ESG's orders were up $16 million or 8%.

SSG reported third quarter sales of $54.8 million, up $1.7 million or 3% from last year. SSG's operating income in Q3 this year was $8.6 million, up 8%. Its Adjusted EBITDA for the quarter was $9.4 million, up from $8.7 million a year ago, and Adjusted EBITDA margin was 17.2%, up 80 basis points from 16.4% in Q3 last year. SSG's orders for Q3 this year were $58.6 million, up $5 million or 9% compared to last year, with the increase largely due to higher global orders for public safety products.

Corporate operating expenses for the quarter were $5.9 million, essentially unchanged from Q3 last year. On a consolidated basis, the increase in sales contributed to an improvement in gross profit of $13.9—$13 million or 19%. Consolidated gross margin for the quarter was 26.6%, up 100 basis points from

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25.6% last year. As a percentage of sales, our selling, engineering, general and administrative expenses for the quarter were down 30 basis points from Q3 last year.

Other items effecting the quarterly results included a $200,000 increase in other expense, and a $100,000 reduction in interest expense. Although tax expense for the quarter was up $1.4 million, largely due to higher pre-tax income levels, out effective tax rate for the quarter was lower than usual at around 22%. During the quarter, we recognized the $600,000 tax benefit following the completion of a tax order in Spain, and an additional $600,000 excess tax benefit from stock compensation activity. With a lower rate in Q3, we are currently expecting our effective tax rate for the full year to be down to a range of 24% to 25%.

On an overall GAAP basis we therefore earned $0.46 per share in Q3 this year, compared with $0.36 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 year quarters. In the current year quarter, we made adjustments to GAAP earnings per share to exclude acquisition related expenses and purchase accounting expense of that. On this basis, our adjusted earnings for the quarter were $0.47 per share, compared with $0.36 per share in Q3 last year.

Looking now at cash flow where we generated $32.8 million of cash from operations in Q3 this year, bringing the total amount of year-to-date operating cash generation to almost $60 million. So far this year we have increased our capital expenditures to $21.2 million as we make strategic investments in new machinery and equipment and other organic growth initiatives, like the expansion of our many factoring facilities in Streator, Illinois, and Rugby, North Dakota.

For the full year, we are currently expecting total cap ex of up to $35 million. As anticipated, we also had a couple of other significant cash-out flows in the quarter. The first related to the acquisition of MRL which we completed at the beginning of July for an initial payment of approximately $50 million. In addition, during the quarter we paid an aggregate sum of $13.4 million to settle the earn-out and fund the deferred payment associated with the acquisition of JJE. Despite these large cash-out flows, our net debt leverage remains at a comfortable level. At the end of the quarter, we had around $240 million of availability under our new upsize credit facility which we executed at the end of July.

The terms of the new facility are more favorable to the Company reflecting the strength of our performance, cash flow, and balance sheet. Our strong financial position allows us to continue to invest in organic growth initiatives, pursue strategic acquisitions, like MRL, and fund cash return to shareholders. On that note, we paid a dividend of $0.08 per share during the third quarter amounting to $4.9 million, and we recently announced a similar dividend for the fourth quarter.

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

Jennifer L. Sherman:

Thank you, Ian. Our third quarter operating results benefitted from seasonally strong performance at many of our businesses. Our earnings also included the effects of a low tax rate which added approximately $0.02 to our EPS and better than expected accretion from our recent MRL acquisition. With the team's intense focus on execution of our strategic initiatives and contribution from MRL we reported double-digit growth in both net sales and orders, and our operating income was up 27% year-over-year. Each of our groups delivered improved Adjusted EBITDA margins translating to a consolidated Adjusted EBITDA margin in excess of 16%, which represents a 140 basis points improvement from Q3 last year.

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Within ESG, in addition to the seasonal strong performance from several of our businesses, including increased after-market demand, we continue to realize operational efficiencies relating to increased production. At our facility in Streator, Illinois, where we manufacture sewer cleaners and safe-digging vehicles, we are continuing our efforts to increase production and reduce lead time, an initiative we internally call BMT, or build more trucks.

Since the third quarter of last year we have added more than 100 employees to the plant, and in the first nine months of this year our unit production at the Streator facility is up 17% compared to the same period of last year. In addition, we have made substantial progress in increasing the number of units produced at our solution centers in Leads, Alabama.

TBEI also had a strong quarter with shipments of dump-truck bodies up 16% year-over-year. Now that we've fully integrated TBEI, our focus has shifted to some of the geographic expansion initiatives we talked about at the time of the acquisition. I recently visited our new location in North Carolina that will serve as an up-sitting center for Ox Bodies brand of dump trucks as we aim to grow our regional presence in this important market.

I'm pleased to report that last week we saw the first unit completed at that location. We also recently entered into a new partnership with a local installer in Texas, as we aim to expand our footprint in that region as well. With some of the cap ex investments we have made since acquiring TBEI, we've also noted improvement in some of our production processes. For example, at certain TBEI facilities, we have invested in laser-cutting technology which has improved both product quality and overall efficiency. This has contributed to an increase in the number of third-party OEM's that have outsourced production of their dump truck bodies to us which they would have previously manufactured inhouse.

Overall order intake in the third quarter of this year remain strong reflecting continued strength in our end markets, contributions from MRL, and ongoing momentum with our strategic initiatives like safe digging and aftermarket. These initiatives contributed to our year-over-year organic order growth of $21 million or 8% in the quarter.

As a reminder our orders in any given quarter can vary due to a number of factors including the timing of receiving large orders, including fleet orders from both domestic and international customers; the availability of customer supply chassis; our own lead time; and the timing of price increases. For example, during the third quarter we saw certain of our ESG dealers place order earlier than we anticipated, and we also received a couple of larger fleet orders for street sweepers from customers in the Middle East.

So far this year, orders for our safe-digging trucks are up $21 million or 28% from the first nine months of last year with most of that growth coming from the continued education of our customers on the safety and efficiency benefits of our range of safe-digging offerings. In addition, rental demand for our safe-digging equipment, the largest component of our rental fleet, remains high with both time and financial utilization levels exceeding our target level.

As an important milestone, we have recently finalized our distribution strategy for our TRUVAC branded safe-digging vehicles including signing the majority of the related agreements. We also continue to focus on expanding our suite of safe-digging offerings. During the quarter, we launched the TRUVAC Coyote, a compact hydro-excavator for utility, municipal, and contractor customers, which maximizes payload and productivity while complying with regional weight regulations.

I want to give a quick update on the status of the expansion of our Vactor facility in Streator. Earlier this week, we held our board meeting at Vactor, and we're able to see firsthand the noticeable progress that's been made thus far. The construction work is well underway with the external structure largely in place and the roof almost complete. The teams have been working hard to try to make up time that was lost

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earlier in the year with the record rainfall in Illinois. While we continue to expect the building to be substantially complete by the end of the year, we do not expect to see any benefits from the expansion until Q2 of next year.

Within SSG, despite some lingering effects of the Ford Model year change, which has impacted the availability of new vehicles in the U.S., our third quarter sales in the public safety markets were up 6% from last year. With the introduction of a series of new products, the teams have been able to further penetrate overseas market and secure orders from several new municipal customers in the U.S.

Last Sunday I attended the International Association of Chief of Police Conference in Chicago, where we showcased the features and functionality of our new Pathfinder system, a feature-rich light and siren controller. The reaction of the customers in attendance of the show was overwhelmingly positive.

We also saw a continuation in the strength of industrial signaling equipment sales with both third quarter and year-to-date sales increasing by around 11%. This improvement has resulted from expanding into new global markets, optimizing our sales channel, and enhancing our marketing effort. As in both first and second quarters, SSG also significantly expanded its margin in the third quarter.

So far this year, SSG has increased its Adjusted EBITDA margin by 270 basis points consistently performing at the upper end of our EBITDA margin target range, which we raised last quarter. The improvement has largely resulted from our pricing actions, improved sales mix, and ongoing execution of our 80/20 or ETI initiative.

I'd like to now give an update on the MRL acquisition which we completed the beginning of July. As a reminder, MRL is a leading U.S. manufacturer of truck-mounted and ride-on-road marking equipment. The acquisition also included the operations of high-mark traffic services, a wholly owned subsidiary of MRL which provides road-marking application and line-removal services.

Since closing the transaction, our collective teams have been focused on integration efforts. As part of our efforts to integrate MRL into a public company, we've made some nominal investments in the form of adding resources or reporting tools which should provide benefits down the road. While we recognize that there's more work ahead, we are pleased with the progress we've made so far. We are also encouraged with MRL's financial performance in the first quarter since the acquisition completed.

As a reminder, primarily due to weather-related factors, MRL's results during the summer months tend to be stronger than other periods while the first and fourth quarters of the year tend to be softer, most notably within its service business which predominately operates in the state of Montana. While MRL exceeded our expectations by adding about $0.02 to our third quarter earnings, the acquisition is expected to be neutral to our fourth quarter earnings.

Turning now to our outlook for the rest of the year. With our impressive third quarter results and the strength of our backlog, we are raising our 2019 Adjusted EPS outlook to a new range of $1.70 to $1.76 from a previous range of $1.64 to $1.72. The new range equates the year-over-year improvement of between 21% and 25%.

I would like to start by reiterating that our current market conditions remain strong as demonstrated by our third quarter intake. In terms of the outlook for 2020, I want to reiterate that the impact from tariffs from Federal Signal that were imposed during the last 18 months or so is nominal. We source an insignificant percentage of our components that are effected by the tariffs that were introduced.

As we begin to look forward into next year the strength of our backlog, particularly for sewer cleaners and safe-digging trucks, provides us with good visibility into the first half of next year. Within in our industrial

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markets, we continue to be bullish about our prospects with respect to our safe-digging initiatives and are monitoring further developments on the regulatory front.

In addition, as I just mentioned, we expect to start seeing benefits from the capacity expansion in the second quarter of next year. The amount of used equipment available at auction continues to be at normal levels, supporting healthy used equipment and rental demands in our market. Utilization levels within our own rental fleet are strong, particularly, for products serving industrial markets like safe-digging trucks and water blasting equipment.

On the municipal front, our U.S. markets remain healthy overall with continued strong demand for sewer cleaners. Within public safety markets, we are hopeful that the lingering effects from the Ford Model year change will be substantially resolved, and SSG will continue to target market-share gains through new product introductions and geographic expansion.

With the upcoming Presidential election and general global economic uncertainty, much of which is outside our control, we do not have good visibility into the second half of next year at this time. We will continue to monitor market conditions closely. We expect our financial position heading into 2020 to be very strong with low debt leverage and ample liquidity allowing us to remain true to our capital allocation priorities.

New product introductions will continue to be a focus with a series of new product offerings scheduled for commercial launch in 2020. Looking further ahead, our innovation teams are working several other longer term projects. For example we have recently designed, built, and tested a plug in hybrid electric sweeper that is now being evaluated by customers. We will also have a full year of MRL activity in 2020 compared to six months this year. The acquisition is performing well so far and remains on track to deliver on the previously announced accretion estimate.

As many of you know our ongoing focus on 80/20, or ETI principles, is an important part of our culture and we continue to educate our people on its principles. Over the last 18 months, over 200 employees have attended various ETI training events.

Lastly, acquisitions will remain an important part of our growth. Our deal pipeline is active. With our healthy cash flow generation and enhanced financial position, we are well positioned to pursue additional strategic acquisition candidates. We will provide a more detailed view on 2020 on our next earnings call.

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

Operator:

Thank you. At this time we'll be conducting an answer-and-question session. If you would like to ask a question today, 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.

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

Jennifer L. Sherman:

Morning, Chris.

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Chris Moore:

Okay. Good morning. Maybe we can start with TBEI, it sounds like integration there is—has gone extremely well. One of the things you talked about when you acquired them, it was a very regional business with potential to do more acquisition in that space certainly existed. Given the expansion that you just talked about in North Carolina, does that—how much additional geographic expansion can you do from the kind of existing infrastructure you have, and how much will require additional acquisitions?

Jennifer L. Sherman:

Yes, great question. As I mentioned on the call, we've opened up a new facility in Highpoint, North Carolina, that we believe geographically is well-positioned to serve that important area. We've also announced the new partnership in Texas. We think there are a number of other opportunities for geographic expansion. What we really try to do is, as we previously talked about, that our dump-truck businesses serve a region of around 800 miles. We're pushing the fringes of those regions with these expansions. We also believe there's opportunity for acquisition in several geographies across North America. As we go forward, we believe the growth will come from both a combination of acquisitions and geographic expansion.

Chris Moore:

Got it, that's helpful. If I am looking at Q4 '19 versus '18, obviously Q4 is, seasonally, both TBEI is a little slower, as you talked about, Mark Rite's a little bit slower, anything else that we should be keeping in mind kind of a year-over-year comparison between Q4 '19 and '18?

Ian A. Hudson:

Yes, Chris. I think Jennifer mentioned that we expect MRL to be neutral to Q4. As you touched on, the seasonal aspects of the business really mean that the fourth quarter tends to be one of the softer quarters primarily in the service business where weather is a factor in Montana, so that's one thing we would mention. The other thing, I think, as we think about the fourth quarter of last year, SSG just had an outstanding fourth quarter last year where they shipped a number of large warning system orders. They had a roughly 21% EBITDA margining for Q4 last year.

Chris Moore:

Great.

Ian A. Hudson:

That's a pretty high bar to meet. The teams are working hard to get there, but it's a pretty tough comparison. Then, the other thing I would just remind you, in Q4 last year within our corporate expenses we had about a $0.02 benefit from some fair value adjustments of certain in reserves we had in the fourth quarter. That's another thing to factor in, because they were essentially non-recurring items that were in the fourth quarter of last year. But even with all of that Chris, I think we're expecting year-over-year improvement in the fourth quarter.

Chris Moore:

That's extremely helpful. I'll jump back in line and I appreciate it, thanks.

Operator:

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

Walter Liptak:

All right, thanks, good morning, great quarter.

Jennifer L. Sherman:

Great morning, Walt.

Walter Liptak:

I wanted to ask with all our industrial companies we're seeing slowdowns, inventory corrections, and things, with the strong order growth and a strong revenue in the quarter, it doesn't look like you're being impacted by anything industrial slowing related. I wonder if you'd just comment on that or are you seeing any pockets or it's just product lines that are feeling the effects of some of the industrial slowdown.

Jennifer L. Sherman:

Yes. We were really encouraged by the growth that we saw in the quarter. We talked about our organic orders were up 8%. Rentals or aftermarket business was up 19% versus Q3 of last year, and again, safe-digging also. Our orders were up 31% over Q3 of last year. Some really good growth in the quarter. In terms of slowness, about 20% of our TBEI business is trailers and those trailers, there's a correlation between those trailers and Class H chassis. We have seen some softness in that market. As we go into 2020, Class H chassis are supposed to be down. I'd remind you though, that the trailers that we manufacture, only a subsection of those Class H chassis and those vocational work trucks are not supposed to be as down as much as Class H chassis. But that is an area that we're seeing some softness, a pretty small part of our business.

As we look at TBEI, we are encouraged by what we are seeing in October so far in dump-truck orders. Again, we talk about this all the time, but we really rather quarter-to-quarter, we'd like to back over the previous nine-month period. But again, it's the metrics that we cited on a call, we're encouraged by what we're seeing, but it's something like every other industrial company, we continue to monitor closely.

Walter Liptak:

Okay, great. Looking at some of the order trends, in the ESG, did you get overall—you called out the sweeper business doing well, it sounds like that grew at least high single digits, as well called out, I think, a street—a couple of other orders. But I wondered, did TBEI grow during the quarter in terms of orders?

Ian A. Hudson:

The orders were pretty much in line, Walt, with where they were last year on the dump trucks. Trailers were, as Jennifer mentioned, trailers were a lot softer than they were last year. But as Jennifer mentioned, from what we've seen so far in October has been encouraging.

Walter Liptak:

Okay, great. You mentioned that ESG dealers placed some orders early in the quarter, I wonder why that timing was there. Was there a price increase that they were getting in front of, or why those orders came in, was there sell-through to end customers? Was there a customer attached to those orders?

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Jennifer L. Sherman:

Yes. We had one of our major dealers place a large order for Pelicans in the quarter. It can vary quarter-to-quarter depending on their delivery needs and when the customer needs them. I think it was critical for them to make sure they got into our queue. We also saw, as I mentioned on the call, a couple large orders out of the Middle East. That was what I was really referring to and it's primarily customer driven.

Walter Liptak:

Okay, all right, sounds good. In the safe-digging markets, the 28% growth, I mean, that continues to support the capacity expansions that you're doing and the strong growth in that market. I wonder if… (cross talking)

Jennifer L. Sherman:

Our board was down there, I mentioned on the call earlier this week, and just really encouraged by what we're seeing. The teams are making good progress, both in terms of the sale side of things, the capacity expansion. In terms of new product development, we talked about we introduced the Coyote, a lot of great energy around our efforts in that market.

Ian A. Hudson:

While at that location, we produced both the safe-digging vehicles, as well as the sewer cleaners that we're now orders for safe digging were up $6.4 million in the quarter. But sewer cleaners were also up, their orders were up about $7 million as well. It's the combination of the demand of those two product lines that will really support the growth, the expansion.

Walter Liptak:

Okay, great. The timing of when that capacity comes online, is there—your comments about the second quarter, is second quarter we'll be at full production starting early in the quarter? Is there a rent period in the first quarter, or are we talking about the ramp starting in the second quarter?

Jennifer L. Sherman:

The ramp will start second quarter.

Walter Liptak:

Okay. The Streator facility will be complete by the end of the first quarter, and then you start ramping trucks out of that plant after that?

Jennifer L. Sherman:

It's more complex than that because there's a sequence of moves that have to occur. We will move into the new— we'll start moving into the new area in the first quarter, but then, we're tearing down some parts of the current buildings, and that will begin and will, in Q1 of next year. We'll start to see the benefits in Q2 of next year of the new space. But then, we need to go back and finish on the existing space. I'd remind you that we were negatively impacted by the weather the first half of the year. We got pushed back a quarter as I reported on the last call. We're still on track to the schedule that I reported on the last call.

Walter Liptak:

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Okay, got it. Okay, thanks again.

Operator:

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

Jennifer L. Sherman:

Morning, Greg.

Greg Burns:

Good morning. Jennifer, you mentioned finalizing your distribution strategy for the TRUVAC line, could you just let us know what that is. Is it going through your existing distribution, the new distributors? How are you going to market those products?

Jennifer L. Sherman:

It's really a combination of all three. In certain markets we go direct; in certain markets we have retained our existing Vactor and Elgin dealers will carry the TRUVAC line; in some markets we will have new distributors, so a combination of all three. The teams did a careful and thorough analysis of the market opportunities in each specific region, then they identified what was the optimum way to go to market in that particular region.

Greg Burns:

In terms of margins, obviously, have been very strong the first part of this year. What would maybe bring the margins back into your targeted range, and is it maybe time to start thinking about reassessing your longer-term target given how strong the margins have been? Thanks.

Ian A. Hudson:

Yes. I think, Greg, when you look at the margin target that we put out there, they're intended to be the not aspirational stretch goals, they're really intended to be ranges where we want to operate kind of quarter-in, quarter-out through the cycle really. We've not, while, from quarter-to-quarter, we may exceed the high-end range. We really need to see that consistent level of performance before we adjust the ranges. Almost like what we saw it with SSG in the second quarter where we raised the high-end of the range to 18% in there. We're still not at the 16% high-end of the range, end of the range on the consolidated basis, if you look at the first nine months of the year, we're at 15.7%. That's up a 140 basis points from where we were at the same time last year. We still haven't hit that high-end of the range, so I think we would want to see a consistent level of meeting or exceeding the high-end range before we increase them. But we're obviously very happy with the performance in margin performance that we've seen this year.

Jennifer L. Sherman:

But, I want to be clear, if we do see that consistent performance, we'll increase them.

Greg Burns:

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Okay. Then, how should we think about the new capacity that's coming online next year? What impact will that have may be on margins or does it create some other efficiency offsets? I just wanted to get a sense of any impact that would have on the margins once that becomes online. Thanks.

Jennifer L. Sherman:

When it's fully operational, we should see some positive efficiency benefits. The teams have done a careful analysis in terms of where there's opportunity to improve flow. As we move forward, and we're fully operational, our expectation is that we'll see benefits on that initiative.

Greg Burns:

Then, lastly, on the MRL seasonality, could you just maybe give us, like I understand the first and fourth are the weakest, but could you just give us a historically percentage-wise, what percent of revenue kind of falls on each quarter so we just could… (cross talking)

Ian A. Hudson:

It's a little tricky, Greg, because historically, as a private company, they never really had to focus on quarterly results. That's been, since we've acquired them, that's been one of the things that we've been working with the teams is trying to get them into the cadence, so, quarterly results forecasting. They really only had kind of a full year. We'd almost have to go back and do some more work to find the actual numbers. But for the most part, we know that new equipment sales, they're fairly stable. But from the service piece of the business, which is about 15% of the overall results, it's almost all of the income is going to be generated in the second and third quarters. I mean, you could probably imagine with the weather effects that there's not much road marking or line removals services being performed in Montana in December, for example.

Jennifer L. Sherman:

It's an also a business too, but given the value of the equipment, if a couple trucks shift quarter-to-quarter, and these can be $500,000 to $600,000 pieces of equipment. As Ian mentioned, we're working with the teams and it's new for them, of the cadence of a quarterly close. But if three or four trucks move from one quarter to another, that also has an impact.

Greg Burns:

Okay, great. Thank you.

Operator:

Thank you. Ladies and gentleman, as a reminder, if you'd like to join the question queue, please press star, one at this time.

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

Marco Rodriguez:

Good morning. Thanks for taking my questions.

Jennifer L. Sherman:

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Morning.

Ian A. Hudson:

Morning.

Marco Rodriguez:

Hey, I was wondering if may be you could talk a little bit more about your gross margins. I know that, obviously, the EBITDA margins are the main focus, but it sounds like that's been a real big help in driving you guys toward the upper end of your EBITDA range, and it seems like a lot of strength is coming in the ESG side. Especially, this particular quarter, year-over-year, 100 basis point improvement. Can you talk a little bit more about what’s sort of driving that. I think you brought out pricing in some of your comments. But if you could provide some more color that would be real helpful.

Ian A. Hudson:

Yes. There's a couple of things, Marco, I'd say, overall, we had 100 basis point improvement if you look at each of the groups, ESG, their improvement was 100 basis points coincidently as well. But SSG had their gross margin was about up by about 250 basis points. SSG is really seeing some of the benefits from the 80/20 initiatives that we've implemented there in recent years. They've had some favorable price benefits. But also, mix has been favorable this time around in terms of the geographic mix, in terms of where a number of those shipments are going internationally, which tends to have a more favorable sales mix.

The other think I would point towards is really the after-market business, and as that is growing, and that tends to carry stronger margins. With the growth we've seen in after-market, that carried some gross margin improvement both in SSG and overall.

Marco Rodriguez:

Got it, very helpful. Then, shifting here to TBEI and the regional growth strategy that you mentioned in the call, obviously, pointing out North Carolina, and I forget the area in Texas, but can you talk a little bit about what is special about those two particular areas that you're expanding into. If so, can you then also share what might be kind of a blueprint we think through as far as the expansion is concerned?

Jennifer L. Sherman:

Yes. The teams have done a couple of things. One is they've, obviously, done a competitive analysis of the territories, which is important in terms of evaluating opportunities. The other critical factor is the proximity to our current facilities. Again, as we looked to expand that region, beyond that 800 mile circle around our particular facilities, that's an important component. We're pushing it out another 500 plus miles.

We're also looking at in terms of availability of labor, which is important. We're really encouraged by—it's small, but we're getting started in High Point, the quality of the workforce. As we move forward, we'll continue—we're getting, we've got two opportunities, a little bit different that we're moving forward with and we're refining our model. We're also looking at these are opportunities to leverage our own FS solution centers as we talked about previously. Again, M&A is going to play an important part in the growth of this particular business.

Marco Rodriguez:

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Got you. If I'm understanding correctly here, the expansion is more about maybe pushing out your existing footprint from you existing areas rather than maybe not necessarily purchasing something that is in a completely different area or geographic location. Is that fair?

Jennifer L. Sherman:

It could be either.

Ian A. Hudson:

It could be either. The High Point expansion, Marco; that is really intended to extend the reach of our Ox Bodies brand. That's located right now, it's located in Faye, Alabama, which is near Birmingham. High Point is going to focus on doing the outfitting of the Ox Bodies, the brand. That's the intention for that location. But, as Jennifer said, in terms of a geographic expansion in other states through M&A, it could be the acquisition of a different brand of dump truck.

Marco Rodriguez:

Okay, got it. Another quick question here, just on the SG&A line item, roughly $43 million. Is that a fair or rather normalized number here now that MRL's in the picture?

Ian A. Hudson:

Yes. It should, I mean, there's obviously, from quarter-to-quarter, there's things that can cause deviation in that number. I mentioned in Q4 last year, we had about $0.02 of a benefit and that would have all—I think that all flowed through the SG&A line. But, there isn't really anything unusual in terms of MRL that would change significantly from Q3 to Q4.

Marco Rodriguez:

Got it. Thanks a lot, guys, appreciate your time.

Jennifer L. Sherman:

Thank you.

Operator:

Thank you. Ladies and gentlemen, this concludes our question-and-answer session. I'll turn the floor back to Ms. Sherman for any final comments.

Jennifer L. Sherman:

Sure, thank you. In closing, I would like to reiterate that we are confident in the long-term prospects for our business and our markets. Our teams are performing at a very high level and we are focused on delivering high-quality results. We remain committed to investing in our businesses and our people to generate sustained long-term success for our shareholders.

Our foundation is strong, and we are focused on delivering profitable long-term growth through the execution of our strategic initiative. We would like to express our thanks to our stockholders, employees, distributors, and customers for their continued support.

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I also want to take this opportunity to thank our many valued dealer partners, including Jack Doheny companies, who continue to demonstrate their ongoing commitment to distributing Federal Signal products, including the Vactor Elgin, and our TRUVAC brand of vehicles.

Thank you for joining us today, and we will talk to you next year.

Operator:

Thank you. This concludes the teleconference. You may disconnect your line at this time. Thank you for your participation.

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