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Federal Signal Corporation

Second Quarter Earnings Conference Call

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PRESENTATION

Operator

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

(Operator Instructions). Please note, this event is being recorded.

I would now like to turn the conference over to Ian Hudson, Chief Financial Officer. Please go ahead.

Ian Hudson

Good morning, and welcome to Federal Signal's second quarter 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 news release which we issued this morning. The slides can be followed online by going to our website, www.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 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.

I'm going to begin today by providing some detail on our second quarter results before turning the call over to Jennifer to provide her perspective on our performance, market conditions, and our outlook for the remainder of 2023. After our prepared comments, Jennifer and I will address your questions.

Our consolidated second quarter financial results are provided in today's earnings release. In summary, we delivered record financial results for the quarter with double-digit year-over-year net sales and earnings growth, gross margin expansion, improved cash generation, a 120 basis point improvement in EBITDA margin, and new records in orders and backlogs.

Consolidated net sales for the quarter were $442 million, a new quarterly record and an increase of $76 million or 21% compared to last year. Organic sales growth for the quarter was $54 million or 15%. Consolidated operating income for the quarter was $59.4 million, up $13.2 million or 29% compared to last year.

Consolidated Adjusted EBITDA for the quarter was $75.5 million, up $17.3 million, or 30% compared to last year. That translates to a margin of 17.1% in Q2 this year, up from 15.9% in Q2 last year. GAAP EPS for the quarter was $0.66 per share, up $0.11 per share, or 20% from last year. On an adjusted basis, EPS for the quarter was $0.67 per share, up $0.14 per share, or 26% from last year.

Order intake for the quarter was again outstanding, setting a new record and surpassing the previous high which we set last quarter. In total, orders in Q2 this year were $480 million, an increase of $67 million, or 16% compared to last year. Backlog at the end of the quarter was $1 billion, another all-time high, and an increase of $212 million, or 27% compared to Q2 last year.

In terms of our group results, ESG's net sales for the quarter were $373 million, up $67 million, or 22% compared to last year. ESG's operating income for the quarter was $56.2 million, up $17.1 million or 44% compared to last year. ESG's Adjusted EBITDA the quarter was $70.7 million, up $19.1 million or 37% compared to last year. That translates to an Adjusted EBITDA margin for the quarter of 19%, an improvement of 220 basis points compared to last year, despite higher chassis revenue, which represented a year-over-year headwind of approximately 90 basis points.

ESG's orders for the quarter were $409 million, an improvement of $57 million or 16% compared to last year. SSG's net sales for the quarter were $69 million this year, up up $9 million or 15%. SSG's operating income for the quarter was $14.1 million, up $3.8 million or 37% compared to last year.

SSG's Adjusted EBITDA for the quarter was $15.2 million, up $3.8 million or 33%. That translates to an Adjusted EBITDA margin for the quarter of 21.9% up 300 basis points compared year. SSG's orders were $72 million, up $10 million or 16% compared to last year. Corporate operating expenses for the quarter were $10.9 million compared to $3.2 million last year, with the majority of the increase resulting from unfavorable changes in fair value adjustments of post-retirement reserves and the non-recurrence of an acquisition-related benefit of approximately $2 million relating to a post-closing adjustment that was received during Q2 of last year.

Turning now to the consolidated income statement where the increase in sales contributed to a $27.5 million improvement in gross profit. Consolidated gross margin for the quarter was 26.5%, a 200-basis point increase over last year. As a percentage of sales, our selling, engineering, general, and administrative expenses for the quarter were up 60 basis points from Q2 last year.

Other items affecting the quarterly results include a $700,000 increase in amortization expense, a $2.3 million increase in acquisition-related expenses, a $1.4 million increase in other expense, and a $3.7 million increase in interest expense.

Tax expense for the quarter was $12.4 million, up $1.3 million from the prior year. Our effective tax rate for the quarter was 23.5% compared to 24.9% last year, with a reduction primarily due to a $700,000 increase in excess tax benefits associated with stock-based compensation activity. At this time, we expect our full-year effective tax rate to be approximately 24%, excluding any additional discrete tax benefits.

On an overall GAAP basis, we therefore earned $0.66 per share in Q2 this year, compared with $0.55 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 quarters. In the current year quarter, we made adjustments to GAAP earnings per share to exclude acquisition-related expenses and environmental remediation costs of a discontinued operation. On this basis, our adjusted earnings earnings for the quarter were $0.67 per share compared with $0.53 per share last year.

Looking now at cash flow, we generated $36 million of cash from operations during the quarter, which was up $21 million from Q2 last year. We ended the quarter with $360 million of net debt and availability under our credit facility of $381 million. Our current net debt leverage ratio remains low, even after funding the acquisition of Trackless that we completed in April for an initial payment of approximately $43 million.

With our financial position remaining strong, we have significant flexibility to invest in organic growth initiatives, pursue strategic acquisitions, and return cash to stockholders through dividends and opportunistic share repurchases.

On that note, we paid dividends of $6.1 million during the quarter, reflecting an increased dividend of $0.10 per share, and we recently announced a similar dividend for the third quarter.

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

Jennifer Sherman

Thank you, Ian.

Impressive execution by both of our groups contributed to a record-setting quarter on many metrics. Within our environmental solutions group, an improving supply chain supported higher production levels, and with increased sales volumes, contributions from recent acquisitions, robust aftermarket demand, and strong price realization, we were able to deliver a 22% year-over-year net sales increase, and a 220-basis point improvement in Adjusted EBITDA margin.

During Q2, we were again able to increase production levels at our largest manufacturing facility, achieving the third successive quarter of production growth as the overall supply chain environment continues to improve. This strong execution contributed to a 35% year-over-year increase in sewer cleaner sales.

In what is typically a seasonally strong quarter, our aftermarket revenues were also up 18% over last year with particular strength in part sales. In addition to strong organic growth, our recent acquisitions also contributed, with Trackless, our most recent acquisition completed early in the quarter, off to a strong start. Collectively, the acquisitions added approximately $22 million to our topline during the quarter.

While we are encouraged by the improving supply chain environment, we are still not out of the woods, and there continue to be pockets of supply-related disruptions for certain components, like hydraulics and pumps. Given that, we are not yet maximizing our production capacity and continue to experience some inefficiencies. Chassis availability also continues to be a constraining factor within our dump body businesses, particularly for our businesses that build on Class 5 chassis.

Our Safety and Security Systems Group, again, delivered impressive results during the quarter with record net sales and Adjusted EBITDA. SSG's second quarter results included 15% topline growth and an adjusted EBITDA margin of 21.9%, a 300-basis point improvement compared to last year and above its target range, which we increased earlier this year.

Over the last few years, we have made several investments in organic growth within SSG, including purchasing the University Park facility and insourcing production of several key components. These investments include the addition of a third printed circuit board line to increase production volumes of public safety equipment, achieve cost savings, and reduce reliance on suppliers. The new production line is expected to be operational in the third quarter. We expect that the broad actions we have taken to mitigate component shortages, including investments to insource production and bring additional suppliers online will provide meaningful long-term benefits to Federal Signal.

Other highlights of the quarter include the publication of our latest sustainability report demonstrating our ongoing commitment to environmental, social, and governance initiatives. The report highlights the progress we have made against our sustainability goals that were established in 2018, including achieving our targeted 10% reduction in water and electricity intensity early.

In the report, we highlight the ways in which we make a difference to our customers, our communities, and our environment. We know that as a global manufacturer of critical infrastructure and safety products, we have the responsibility to do the right thing, operate sustainably, and with a long-term fact-based view on issues regarding the environment, society, and corporate governance, and positively impact our employees, customers, partners, and stakeholders at large. These efforts also position us well in the communities in which we operate and serve as a differentiating factor in our ability to attract labor at most of our facilities.

Demand for our products and our aftermarket offerings remains at unprecedented levels with both our orders and backlog this quarter again setting new company records. As we've talked about previously, there are several macroeconomic tailwinds contributing to the strong demand we are currently experiencing.

Within our municipal markets, we are continuing to see the benefits from the American Rescue Plan, which, in 2021, earmarked $350 billion for state, local, and territorial governments for a variety of purposes, including the maintenance of essential infrastructure, such as sewer systems and streets. In the second quarter, municipal orders were up 13% compared to last year, primarily driven by significant increase in demand for sewer cleaners. As a reminder, approximately 75% of our sewer cleaner orders include a hydro-excavation or safe digging package, allowing the unit to be utilized in a variety of applications.

We also continue to expect meaningful multi-year tailwinds arising from the $1.2 trillion Infrastructure Act, which has $550 billion earmarked for new investments in roads, bridges, power, water, and broadband infrastructure, public transportation, and airports. To date, nearly 35,000 projects have been awarded funding from the bipartisan infrastructure law. They range from repaving roads and water system upgrades funded through formula grants, to state, to competitive funding for massive bridge and transit projects. Our teams are working with our customers in the designated areas as they evaluate their equipment needs to support these large multi-year scale projects.

With the funding available to support broadband infrastructure development, we have seen additional interest in our broad range of safe digging product offerings that can vacuum excavate and/or convey materials in a safe and efficient manner. With that, orders for safe digging trucks were up 20% compared to the prior year.

As another example of the potential application for the use of our safe digging products, there is a significant effort in California to mitigate the risk associated with wildfires with a major utility company recently announcing that it is seeking $8 billion in funding to bury power lines underground. We are also continuing to see benefits from the infrastructure bill within SSG, in particular with higher demand for warning systems.

The Infrastructure Act earmarked $6.8 billion for the Federal Emergency Management Agency, or FEMA, to invest in disaster mitigation programs. This includes $500 million over five years to provide hazard mitigation assistance to local governments through the STORM Act. To date, we have received over $4 million in warning system orders supported by FEMA funding and are currently working with several counties that have been awarded grants totaling several million dollars to expand their tornado warning systems.

We have received multiple proposals from communities across the country that are seeking government grants from this funding source to update or expand warning systems. As part of our warning system offerings, we are also provide ongoing maintenance and subscription alerting services which following the initial sale of the warning equipment provide for a long-term recurring revenue stream. SSG has recently introduced a couple of new features key to advancing the safety and security of communities and workplaces.

The first is lightning detection and alerting, which are additions to our flagship CommanderOne outdoor warning siren activation and monitoring system. This feature is ideal to alert industrial chemical plants, outdoor recreational areas, parks, and campuses where lightning is a threat to employees and communities. The second is a new option for siren communication with our IoT family of products. These devices allow for quick upgrades from legacy radio technologies to secure to cellular communication. With higher frequencies of natural disasters such as wildfires, hurricanes, tornadoes, and floods, we are proud that our products play a role in helping to keep communities safe.

During the second quarter, the U.S. Department of Energy also released a notice of intent to invest $2 billion from the Inflation Reduction Act to accelerate domestic manufacturing of electrified vehicles. These investments are expected to be made available in the coming months. Electrification remains a key area of investment for the Company, and we expect this public funding source to support future growth related both to our EV product lines, as well as our platform of specialty vehicles that support metal extraction.

During the second quarter, despite increased production levels that contributed to record quarterly sales, our orders once again exceeded shipments. In fact, the second quarter represented the 10th successive quarter that our orders have outpaced sales. With this unprecedented demand contributing to record backlogs, lead times for certain products have become extended and consequently, we may see some lumpiness in ESG order trends as we move forward, which may impact comparability from quarter to quarter.

In addition, while orders within SSG in the front half of the year were outstanding, including benefits from certain large fleet orders, we may see some moderation in SSG orders in the second half of the year with Ford scheduling a police vehicle model year changeover in Q4. We remain focused on increasing production levels to build more trucks as we aim to reduce current backlog and lead times while continuing to maintain healthy order intake.

I now want to take a few minutes to provide an update on a couple of our organic growth initiatives. Our focus on 80/20 improvement is deeply ingrained in our culture and it's played and will continue to play a key role in driving our organic growth and industry-leading margins. As discussed in the last earnings call, we hired a dedicated resource tasked with driving additional throughput projects across many of our businesses as we seek to reduce current lead times at several of our businesses. This resource has already conducted a series of 80/20 and lean manufacturing sessions.

At our Elgin Street Sweeper facility, lean initiatives have initially focused on synchronizing fabrication and paint processes within assembly demand. This improved flow is expected to increase throughput by eliminating double handling of materials, maximizing paint line capacity, and assembly productivity.

At our Travis Body and Trailer facility, the Management team initiated a product line simplification initiative similar to the successful Ox Bodies dump body SKU reduction that we talked about in our last earnings call. The Travis team identified over 9,500 current combinations of trailer offerings, and the first round of its 80/20 analysis achieved a 30% reduction in variations with continued standardization underway.

Moving on to aftermarkets, which represented approximately 28% of ESG's revenues during the quarter, mainly due to the strength of part sales that I noted earlier. Aftermarkets remains a key strategic initiative of ours, and we see additional opportunities to grow that business by expanding into new geographies.

In addition, we made meaningful investments in the first half of ‘23 to replenish our rental fleet and support the anticipated continuation of high demand for rentals and used equipment. We also continue to invest in new product development, and I wanted to touch on a few recent product innovations.

During the second quarter, SSG introduced the HighLighter Elite, a new design of our popular Mini Light Bar with improved optical performance and a sleeker, more attractive appearance. The wide variety of mounting options, colors, and flash patterns ensure there is a suitable model for on-road or off-road utility, towing, and construction vehicles.

In addition, reduced availability of Class 3 to Class 5 chassis continues to be a constraint for our dump body business. As a result, our teams have launched products that utilize chassis that currently have more availability. As an example, we recently introduced an aluminum dump body product offering designed for the widely available Ford F350 pickup chassis that has been well-received in the market.

On the M&A front, we were pleased to announce the closing of the Trackless acquisition in April and are encouraged with its financial performance in the quarter. Trackless is a leading Canadian manufacturer of multi-purpose off-road municipal tractors and a variety of attachments will provide year-round value to its customers. The Trackless integration is well underway and we are excited about the opportunities to leverage our existing distribution channel in the U.S. to expand the geographic reach of Trackless products and accelerate the growth trajectory of this business.

Our continued growth through disciplined M&A differentiates Federal Signal as an accumulator of leading brands of specialty vehicles and supporting aftermarket offerings. Our deal pipeline remains very active and we continue to expect M&A to be an important part of our future.

Turning now to our outlook for the rest of the year. Demand for our products and our aftermarket offerings remains at unprecedented levels with both our orders and backlog this quarter again setting new company records. With our second quarter performance, our record backlog, and improving supply chain conditions, we are raising our full year adjusted EPS outlook to a new range of $2.30 to $2.46 from the prior range of $2.21 to $2.43. We are also increasing the low end of our full year net sales outlook range by $30 million, establishing a new range of $1.65 billion to $1.72 billion.

At this time, I think we are ready for questions.

Operator?

Operator

Thank you. (Operator Instructions). Our first question comes from Steve Barger with KeyBanc Capital Markets. Please go ahead.

Jennifer Sherman

Good morning, Steve.

Ian Hudson

Hi, Steve.

Christian Zyla

Good morning. This is actually Christian Zyla on for Steve Barger. Thank you guys for taking my question.

Jennifer Sherman

Good morning.

Christian Zyla

Good morning. My first question is on ESG. If we just take the average of your two best quarters in ESG, I get about $350 million in quarterly sales. Is it reasonable to think you guys can run at that rate or even above for an extended period of time as long as you can get chassis and other components with minimal disruptions? Then, I know you mentioned you're still not maximizing your production capabilities, but what needs to happen in the supply chain to get you to that point, and when do you think that happens?

Jennifer Sherman

First answer to your question is yes. The second part is a couple of things. One is we need consistency. What we're seeing now is episodic type issues. It is improving supply chain. But we'll have—we talked about in the prepared remarks, we'll have a problem with a particular component and then we'll have to pull a product off the line until that component becomes available. The good news is now we're typically talking about weeks, not months. We're able to solve the problem. That contributes to inefficiencies because we often have to retest the vehicle and we're not running them down the line, but instead we're bay building them.

The area that we need to see improvement is chassis availability for our TBEI businesses. There's still constraints in that, particularly in that Class 5 chassis which impact a couple of our businesses. We have the chassis we need for our non-TBEI businesses for 2023, but we're continuing to look at opportunities to increase production in our TBEI businesses, and that's contingent upon chassis availability, particularly Class 5.

Christian Zyla

Great. Thank you. My second question, I know M&A deals are far and few between right now, but what types of businesses are you guys interested in? Is your priority still to enhance some of those underperforming dealers and maybe bring them in? From your conversations, are higher rates causing more family-owned businesses to maybe consider monetizing at a faster pace? Is there any color—commentary on that landscape? Thank you.

Jennifer Sherman

Sure. As we talked about in the call, we continue to evaluate opportunities. Our pipeline is full. We're looking at a number of different types of opportunities at a number of different sizes. We continue to look at specialty vehicle type opportunities. We're looking, as you referenced, opportunities to continue to grow our aftermarkets. We work very closely with our dealer partners, particularly when they might be interested, as you referenced, in some type of liquidity event. We're pretty encouraged by the opportunities we're seeing, and we've seen multiples come down. M&A will continue to play a meaningful part of the growth story at Federal Signal.

Christian Zyla

Great. If I could just squeeze one last one in?

Jennifer Sherman

Sure.

Christian Zyla

Could you just compare and contrast your visibility for your municipal versus industrial customers? What does the visibility look like for each? In regards to your growing and elevated historic backlogs, could you parse out? Does that skew more one way or another, or is it kind of split in terms of the backlogs and orders out there? Thank you so much.

Ian Hudson

Yes. It's fairly evenly split, Christian. With the growth that we've seen in orders, it's been almost across the board, both municipal and industrial. On the one hand, on the municipal side, we've seen some benefits from the American Rescue Plan Act, as Jennifer mentioned. Then on the industrial side, that's where the infrastructure bill would, we would typically see some benefits there. When we look at the backlog, it's really a nice mix of municipal and then a variety of industrial applications. We talked about the variety of applications for our safe digging products. It's not necessarily any one particular industrial end market. It's really a variety of them. But there's a nice—but there's also some international business in there with the growth that we've seen within SSG on that side of the business, too. Yes. A nice healthy mix.

Christian Zyla

Great. Thank you so much.

Jennifer Sherman

Thank you.

Operator

Our next question comes from Chris Moore with CJS Securities. Please go ahead.

Jennifer Sherman

Good morning, Chris.

Chris Moore

Hey, good morning, guys. Good morning. Congrats on another incredible quarter.

Jennifer Sherman

You and we.

Chris Moore

That's right. Recognizing that much of the infrastructure funding has long tails, I'm just trying to figure out a way to get a sense of how much these bills, the American Rescue Plan, Infrastructure Jobs Act, how much have they provided to this point in time versus what you think is going to happen over the next few years? Have you gotten 20% of what you think you're going to get, or is there any way to guesstimate that?

Jennifer Sherman

Yes. There's pretty good data on the White House website, I would refer you to that. To date, we really haven't seen a lot of orders from the infrastructure bill. According to the website, really they're at step three of the process where they've decided the types, they've awarded the particular programs, and right now, the recipient agencies are agreeing to the conditions of the award, and then after that, they'll put those out for bid, and our customers, our contractors, will start to respond to those bids. We're getting a lot of inquiries about, look, a particular customer might be aware of a project in their area that's been announced, and they know that they're going to bid on that project. They're starting to line up their equipment, asking us about availability of equipment. But it is something we believe that we haven't seen a lot of the orders, and it's yet to come. That's one of the reasons we're very encouraged. But pretty good data on the White House website about where they are in the process. According to that data, they're still in the negotiation of the awards.

Chris Moore

Got it. Very helpful. When you look at the backlog today, a little better than a billion, maybe just talk in terms of how you're viewing the pricing of the backlog today versus six months ago, nine months ago?

Ian Hudson

Yes. I think we're in a good position with the various pricing actions that we've taken. We've also seen some moderation, I would say, in some of the inflation. I think we're in a good position as we move forward from a year-over-year comparison. We started to see some benefits from the pricing actions we took in the second half of the year, the year-over-year impact might not be as significant as it was in the first half.

Jennifer Sherman

We saw very strong price realization in the quarter.

Chris Moore

Got it. That makes sense. All right. I will leave it there. Thanks, guys.

Ian Hudson

Thanks, Chris.

Operator

Our next question comes from Mike Shilsky with D.A. Davidson. Please go ahead.

Mike Shilsky

Good morning. Thanks for taking my question. You kind of beat me to it on the California comments about wanting to bury out of the power lines and the other infrastructure. Maybe I'll turn to lead pipes. That appears like it's starting out very early, but it's going to be the next asbestos, all those buried lead pipes around the country, reaching into the soil. It's just starting to hit the news headlines the last couple of months or so. Do you see Federal Signal playing a big role in your products in helping to dig up all those lead pipes safely and get them replaced? Or am I thinking of this the wrong way as to how they're going to have to remediate all that lead in the soil?

Jennifer Sherman

When I saw the *Wall Street Journal* article, I circulated it to our team. It's a great, perfect application for our safe digging trucks. We think we're in a good position to assist those contractors with those multi-year projects.

Mike Shilsky

Outstanding. I also want to just get a quick question on SSG and your EBITDA range. I think you just put that guidance range up a little higher a few months ago. At this point, you've already exceeded it. I'm curious if you feel like maybe you may have undershot things already out of the gate here. Maybe it actually is a little bit higher than you had thought just a few months back on a more long-term basis. Or were there any temporary items here in this particular quarter that were unusually supportive of margins due to either price cost or unusual contract that are one-time in nature? Any kind of comment there on the SSG outlook, I would appreciate.

Ian Hudson

Yes. We had a—I think we mentioned it on our last call, we had a pretty significant fleet order from a customer in Mexico in the first quarter. Some of that spilled over into Q2 in terms of the shipment. That was kind of an unusually large contract, I would say, that was in the first half of the year that we're not necessarily expecting that to repeat in the second half. We also are aware of, I think Jennifer mentioned in her prepared comments, that Ford is planning to do a model year changeover. Police vehicle production will be down in Q4 to allow for that changeover. That will be a factor in the second half of the year in terms of the order trends within SSG. I think we're obviously thrilled with the performance of SSG since we raised the targets. I think, long-term, we still believe that those targets are appropriate. It can vary quarter to quarter. I think the other thing I've mentioned, in Q4 we typically see, or historically, we we have seen some unexpected orders as municipalities get towards the end of the year, mainly on the system side. We can tend to see some larger systems orders in Q4. That might be something that causes some variability in the margin profile.

Jennifer Sherman

About longer term, as I talked about earlier, we're making a number of investments at SSG with respect to automation, insourcing, and we are very excited about the long-term impact that those investments will have on the margin performance of the business.

Mike Shilsky

Okay. Just a follow-up there going to the ESG segment, it sounds like because you're still facing some supply chain issues, you're not ready to change that outlook yet. But I'm curious, there are still some challenges in supply chain for that group. It's probably never been perfect, even pre-pandemic, there's always been—there's always something. How far off are you from pre-pandemic minor challenges as opposed to anything major currently?

Jennifer Sherman

I'll be really blunt, we need to see improvement in chassis availability for our TBEI business and we need to see consistency on supply chain, not perfection, but we need—we can't be in positions where we're pulling multiple trucks offline for weeks. But the encouraging news is with respect to the supply chain issues, we're getting better, and it's improving. But I would say, we're also looking at waiting for the chassis allocations for 2024. That's critical as our teams are very focused on building more trucks on BMT and increasing production levels. I'm encouraged by the progress made today, but those factors that I cited are the factors that we're monitoring. But I'll conclude with, we are committed to raising those ESG margin targets and the overall margin targets of the Company.

Mike Shilsky

All right. (Inaudible) I'll leave it there. Thank you.

Ian Hudson

Thanks, Mike.

Operator

Our next question comes from Walt Liptak with Seaport Research. Please go ahead.

Walter Liptak

Hey, good morning, guys, and congratulations, great quarter.

Jennifer Sherman

Thank you. Good morning, Walt.

Walter Liptak

Wanted to ask you a couple of follow-ups here. On SSG, I think some of the comments are positive and then some moderation at the same time. By that I mean, you've got that third production line coming on and you just mentioned that that's going to have some profit benefits. But then I think when Ian was talking about fleet orders, he was talking about international fleet orders and that something might not repeat. You talked about the orders coming down in SSG. The question is, are we going to expect SSG orders to come down? Can you give us some more detail about that? What do you think profitability in SSG looks like in the third quarter with the production ramp? Are these profit levels sustainable?

Ian Hudson

Yes. I think, Walt, the order I was referencing, the fleet order, that was what we talked about in Q1, that was about an $11 million order from Mexico. It was, basically, they ordered enough for the full year. That won't necessarily repeat again in the second half of the year. That would be a consideration. Then on top of that is the changeover within the police business in Q4. The second half orders within SSG probably won't be at the same level as they were in the first half, but we're still expecting healthy order intake as we've made some great strides with some of our new products. On the margin profile, I think we still believe the 17% to 21% range that we gave at the beginning of the year, we still think that's appropriate and we would expect to be within that range in the second half of the year.

Walter Liptak

Okay. Great. The third question.

Jennifer Sherman

I'll add, Walt, longer term, our teams are very active in international markets. Longer term, there's several major orders that they're working on right now that over time, we'll continue to see. Then after the Ford model changeover, which is something that's been planned for a while, there'll be some catch-up work too as we move through ‘24.

Walter Liptak

Okay. Great. I wanted to ask about the upfitting project. Jen, how are things going in SSG for the upfitting? Is that a profitable business?

Jennifer Sherman

Absolutely. I've been at—I was in Spain during Q2, and the teams—we have two facilities now that are focused on upfitting. What's really exciting is we've been able to secure orders that we wouldn't have otherwise received as a result of that strategic initiative. Our teams have done just an excellent job in Europe. In the States, we're earlier on that journey, but they've had some wins and we're encouraged by what we're seeing.

Walter Liptak

Okay. Great. Then maybe just the last one on the—it's nice to see the safe digging orders. I wonder if you can provide some insight into what kind of customer orders are these? Are you starting to see some of the larger utility fleet orders or any of the service providers or are these mostly municipal orders?

Jennifer Sherman

Yes. Well, the municipal orders would come through as, as we talked about on the call, that approximately 75% of our sewer cleaner orders include a safe digging package. The orders we were talking about being up year-over-year were really on the industrial side of things. We haven't seen yet the large fleet orders that we're expecting from utility contractors and industrial contractors resulting from the infrastructure funds. That is more good to come.

Walter Liptak

Okay. Great. Okay. Thank you.

Operator

Our next question comes from Greg Burns with SIDOTI & Co. Please go ahead.

Gregory Burns

Good morning.

Jennifer Sherman

Good morning, Greg.

Gregory Burns

I just want to touch on maybe some of the cross-selling opportunities you have with some of the new acquisitions, more recent acquisitions you've done. Yes. I think you mentioned some opportunities with Trackless to bring that—use your distribution to bring that to the U.S. But what are maybe some of the opportunities to maybe accelerate growth of some of these brands that you've bought across your footprint? Thanks.

Jennifer Sherman

Sure. Great question. Let's start with our Ground Force acquisition. We, last year, acquired TowHaul, and the integration is going very well. The teams are—both sales teams are working closely in terms of cross-selling opportunities. We have really strong leadership teams out there, and we're encouraged by some of those opportunities to date. With respect to Trackless, we closed the transaction this quarter. The integration is going well. We're very focused on—they do an excellent job with respect to winter attachments. They've got a number of great summer attachments. We're looking at working with our dealer partners to grow that particular business, but they're off to a strong start.

Then in terms of purchasing synergies, our purchasing teams, ESG, have worked closely with our new acquisitions and are identifying opportunities there. Then I'd be remiss if I didn't talk about our efforts in Colorado, Montana, and Wyoming. We're approaching that as it carries our Vactor, our Elgin, our TRUVAC brands. Ultimately, we'll have TBEI brands. Our JetStream brand will join that group in September. There'll be a number of cross-selling opportunities. Then finally, our Blasters acquisition, the teams are working very closely with our MRL group and our JetStream teams, and those integrations are going well. Again, yet another opportunity to pursue cross-selling.

Gregory Burns

Okay. Great. Thank you.

Operator

Our next question comes from Dave Storms with Stonegate. Please go ahead.

Dave Storms

Good morning.

Ian Hudson

Good morning, Dave.

Jennifer Sherman

Good morning.

Dave Storms

Good morning. Just a quick question around pacing. I know there was a lot of optimism last quarter around Q3. Was any of the strength seen in the second quarter a pull forward from 3Q, or should we think about them separately?

Ian Hudson

We'll probably think about them separately, Dave. I think we had a strong finish to the quarter, but I still think we're expecting Q3 to be a strong quarter. Again, it's a seasonally strong period from an aftermarket standpoint, and with the levels that we're seeing, demand for rental, demand for used equipment, demand for parts, still pretty strong. We'd expect Q3 to be a strong quarter as well.

Dave Storms

That's very helpful. Thank you.

Operator

That concludes our question-and-answer session for today. I would now like to turn the conference back over to Jennifer Sherman, Chief Executive Officer, for any closing remarks.

Jennifer Sherman

Thank you very much.

In closing, I would like to reiterate that we are confident in the long-term prospects for our businesses and our markets. Our foundation is strong and we are focused on delivering profitable long-term growth through the execution of our strategic initiatives. Our employees are working hard to deliver. We would like to express our thanks to our stockholders, our employees, distributors, dealers, and customers for their continued support. Thank you for joining us today and we'll talk to you soon.

Operator

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.