**Federal Signal Corporation**

**First Quarter Earnings Conference Call**

**May 2, 2023**

## CORPORATE PARTICIPANTS

**Ian Hudson,** *Chief Financial Officer*

**Jennifer Sherman,** *Chief Executive Officer*

## CONFERENCE CALL PARTICIPANTS

**Chris Moore,** *CJS Securities*

**Mike Shlisky,** *D.A. Davidson*

**Felix Boeschen,** *Raymond James*

**Steve Barger,** *KeyBanc Capital Markets*

**Walter Liptak,** *Seaport Partners*

**Dave Storms,** *Stonegate Capital Markets*

## PRESENTATION

**Operator**

Good day, and welcome to the Federal Signal Corporation First 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 first quarter 2023 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, 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.



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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 first 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 the year. After our prepared comments, Jennifer and I will address your questions.

Our consolidated first quarter financial results are provided in today's earnings release. In summary, we delivered strong financial results for the quarter with double-digit year-over-year net sales and earnings growth, gross margin expansion, a 130-basis point improvement in Adjusted EBITDA margin, and new records in orders and backlog.

Consolidated net sales for the quarter were $386 million, up $55 million or 17% compared to last year. Organic sales growth for the quarter was $44 million or 13%. Consolidated operating income for the quarter was $39.5 million, up $11 million or 39% compared to last year.

Consolidated Adjusted EBITDA for the quarter was $54.5 million, up $12.3 million or 29% compared to last year. That translates to a margin of 14.1% in Q1 this year, up from 12.8% last year. GAAP EPS for the quarter was $0.45 per share, up $0.12 per share, or 36% from last year. On an adjusted basis, EPS for the quarter was $0.46 per share, up $0.12 per share, or 35% from last year.

Order intake for the quarter was outstanding and we again reported record orders, surpassing the previous high, which we set in Q1 last year. In total, orders in Q1 this year were $475 million, an increase of $22 million or 5% compared to Q1 last year. Backlog at the end of the quarter was $968 million, another all-time high for the Company, and an increase of $216 million or 29% compared to Q1 last year.

In terms of our group results, ESG's net sales for the quarter were $319 million, up $45 million or 16% compared to last year. ESG's operating income for the quarter was $37.6 million, up $10.8 million or 40% compared to last year. ESG's Adjusted EBITDA for the quarter was $51.2 million, up $11.9 million or 30% compared to last year. That translates to an Adjusted EBITDA margin for the quarter of 16.1%, an improvement of 180-basis points compared to last year, despite higher chassis revenues, which represented a year-over-year headwind of approximately 40-basis points.

ESG reported total orders of $396 million in Q1 this year, an improvement of $8 million or 2% compared to last year. SSG's net sales for the quarter were $67 million, up $11 million or 19% from last year. SSG's operating income for the quarter was $12.1 million, up $4.2 million or 53% compared to last year. SSG's Adjusted EBITDA for the quarter was $13.2 million, up $4.3 million or 48%. That translates to an Adjusted EBITDA margin for the quarter of 19.8% towards the upper end of SSG's new target range and up 390-basis points compared to last year.

SSG's orders for the quarter were $79 million, up $14 million or 21% compared to last year, with much of the increase resulting from the receipt of a large fleet order for public safety equipment from a customer in Mexico. Corporate operating expenses for the quarter were $10.2 million compared to $6.2 million last year, with about half of the increase resulting from unfavorable changes in fair value adjustments of post-retirement reserves.



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Turning now to the consolidated income statement, where the increase in sales contributed to a $20.1 million improvement in gross profit. Consolidated gross margin for the quarter was 24.9%, 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 30 basis points from Q1 last year.

Other items affecting the quarterly results include a $300,000 increase in amortization expense, a $400,000 increase in acquisition-related expenses, a $500,000 reduction in other income, and a $3.4 million increase in interest expense.

Tax expense for the quarter was $7.3 million, up $200,000 from the prior year. Our effective tax rates for the quarter was 21% compared to 25.7% last year, with the reduction primarily due to a $900,000 increase in excess tax benefits associated with stock-based compensation activity, and the recognition of a $500,000 benefit associated with changes in tax reserves. At this time, we expect our full year effective tax rate to be between 24% and 25%, excluding any additional discreet tax benefits.

On an overall GAAP basis, we therefore earned $0.45 per share in Q1 this year compared with $0.33 per share in Q1 last year. To facilitate earnings comparisons, we typically adjust our GAAP earnings per share for unusual items recorded in the current or prior quarters. In the current year quarter, we made adjustments to GAAP earnings per share to exclude acquisition-related expenses. On this basis, our adjusted earnings for the quarter were $0.46 per share compared with $0.34 per share last year.

Looking now at cash flow. We generated $7 million of cash from operations during the quarter, which was about the same level as Q1 last year, despite a meaningful increase in rental fleet investment during the quarter, to support anticipated strength in rental and used equipment demand. We ended the quarter with $337 million of net debt and availability under our credit facility of $415 million. Our current net debt leverage ratio remains low, even after funding the acquisitions of Blasters and Trackless.

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 sharing purchases.

On that note, we paid dividends of $5.5 million during the quarter, reflecting a dividend of $0.09 a share, and we recently announced that we are increasing the dividend by 11% to $0.10 a share in the second quarter.

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

**Jennifer Sherman**

Thank you, Ian.

Over the last several years, we have put several building blocks in place to fuel the long-term growth of the Company. This has included making significant investments in plant expansions, new product development, and strategic acquisitions that have expanded our product offerings and geographic footprint. With those pillars in place, we announced on our year-end earnings call that we are expecting 2023 to be another record year for Federal Signal.

We are off to a strong start with our Q1 net sales EPS at the highest level in the Company's history for the first quarter of the year. Within our Environmental Solutions Group, an improving supply chain supported higher production levels with increased sales volumes, contributions from recent acquisitions, robust aftermarket demand, and strong price realization, we were able to deliver a 16% year-over-year net sales increase and a 180-basis point improvement in Adjusted EBITDA margin.



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During Q1, production at two of our largest manufacturing facilities within ESG improved by 17% compared to the fourth quarter of 2022. This represents the second consecutive quarter of double-digit production growth, and the teams achieved their highest average daily build rates since Q1 of 2020. This strong execution contributed to a 27% year-over-year increase in street sweeper sales and double digit increases in sales of both sewer cleaners and safe digging trucks.

Our aftermarket team also had another strong quarter with overall aftermarket revenues in Q1 this year, up 22% over last year, with particularly strong parts sales. To meet growing demand, our FS Depot parts business has successfully increased its workforce, and during the first quarter, had a significant focus on reducing backlog and improving lead times in order to deliver essential parts to our dealers and minimize equipment downtime for our end customers.

In addition to strong organic growth, we are pleased with the contributions from M&A during the first quarter. Ground Force and TowHaul continue to perform in line with our expectations. We also completed the acquisition of Blasters in January, and the team is off to a strong start.

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, specifically hydraulics and pumps. Given that we are not yet maximizing our production capacity, 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 also delivered impressive results during the quarter, including 19% top line growth and an Adjusted EBITDA margin of 19.8%, a 390-basis point improvement compared to last year, and towards the high end of the new target range announced on our last earnings call of 18% to 21%.

As Ian mentioned, during the quarter, SSG was awarded a large international fleet order for public safety equipment and the team was able to promptly deliver about a third of the equipment during Q1. This order was another success story for the team in penetrating new geographic markets with new product introductions such as the Allegiant and Reliant value line of light bars.

In addition, we continue to grow domestic market share and recently secured fleet orders with several new state and local municipality police departments. Overall, sales and public safety equipment in Q1 this year were up $4.5 million or 12% compared to Q1 of last year. With supply chains continuing to ease, we also saw a 35% year-over-year increase in sales of industrial signaling equipment. Demand remains strong and the team is focused on increasing throughput to reduce lead times.

Over the last several years, we have made meaningful investments in organic growth within our SSG business, including purchasing the University Park facility, and insourcing production of several key components in order to reduce our reliance on overseas suppliers. For example, during the first quarter of 2022, we launched the in-house production of our MicroPulse line, which leverages automated laser technology. The MicroPulse is a low profile, high performing LED lighting product for both first responder and work truck vehicles.

The line includes production of both new product models and those that were previously outsourced. With the incremental revenues from new product models and lower cost production of previously outsourced models, the MicroPulse production line has improved product margins and generated incremental operating income of approximately $1.5 million in '22 with further growth projected in 2023.

In addition, we have recently invested in a third printed circuit board manufacturing line at University Park to increase production volumes of public safety equipment, achieve cost savings, and reduce reliance on



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our suppliers, which have been unable to meet our current demand. The new production line is expected to be operational in the third quarter of 2023. We expect the broad acts taken to mitigate component shortages, including investments to in-source production and bring additional suppliers online, will provide meaningful long-term benefits to Federal Signal.

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. There are several macroeconomic tailwinds contributing to the strong demand, and I'll highlight a few of the key market trends today. Within our municipal markets, we are continuing to see benefits from the American Rescue Plan Act, 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 first quarter, municipal orders were up 11% compared to last year, primarily driven by significant street sweeper demand. 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.

For example, increased demand and spend on broadband infrastructure is generating additional interest and our broad range of safe digging products that can vacuum, excavate and/or convey materials in a safe and efficient manner. While we typically discuss this public funding source in the context of our ESG product offerings, we are also seeing the benefits 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. Typically, FEMA allocates around $50 million annually for tornado flood and fire warning projects, but under the Act, funding to FEMA is anticipated to increase by 50% annually over the five-year period.

To date, we have received hundreds of proposals for communities across the country that are seeking government grants from this funding source to update or expand warning systems and are currently working with two counties that have been awarding grants totaling several million dollars to expand their tornado warning systems.

As part of our warning systems offering, we also provide ongoing maintenance and subscription alerting services, which following the initial sale of the warning equipment, provide for a longer-term recurring revenue stream. With higher frequencies of national disasters such as wildfires, hurricanes, tornadoes, and floods, we are proud that our products play a role in helping to keep communities safe.

Electrification remains a key area of investment for the Company and during the quarter, we showcased our newest vehicle electrification offerings at large trade shows. Vehicle electrification and other green initiatives are expected to drive demand not only for our EV product offerings, but also from the corresponding increase in long-term demand for lithium batteries.

With the acquisitions of Ground Force and TowHaul, we have created a platform of specialty vehicles that support the extraction of metals and minerals, including lithium. With expectations that global demand for lithium-ion battery in many end markets will grow at a CAGR of approximately 30% over the next 10 years or so, we are energized about the positive growth trajectory in this end market.

I now wanted to take a few minutes to provide an update on a couple of our internal initiatives. Our focus on 80/20 improvement is deeply ingrained in our culture, and has played, and will continue to play, a key role in driving our organic growth and industry leading margins.



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As an example, we recently completed a product line simplification 80/20 initiative for our OX BODIES line of dump trucks, where the team was able to analyze the sales history to identify two leading product lines that comprise approximately 90% of its revenues.

The team then identified the most commonly ordered dump body specifications for these product lines, and through this product line simplification process, was able to reduce its standard offerings from over 4,200 body combinations to less than 400, achieving a 90% reduction in SKUs. This 80/20 improvement initiative is expected to result in annual savings of $650,000 at this plant.

We recently hired a dedicated resource on the corporate tasks with driving additional throughput improvement projects across many of our businesses. In addition, this resource will play a key role in implementing and publishing our federal signal enterprise operating system. With our continued growth through M&A, this playbook will also support long-term value creation as we continue to standardize and implement lean manufacturing solutions at acquired businesses.

Moving on to aftermarkets, which represented approximately 27% of ESG's revenues during the quarter, mainly due to the strength and parts sales that I noted earlier. Aftermarket remains a key strategic initiative of ours and we see additional opportunities to grow that business by expanding into new geographies that we believe to be underserved.

During Q1, our new facility in Colorado was opened and we have already regained a large street sweeper fleet order with a major municipality in the region. This facility will support sales of many of our product lines in the region, including Elgin, Vactor, TRUVAC, and Jetstream. In addition, as Ian noted, we have made meaningful investments in Q1 to replenish our rental fleet and support the anticipated continuation in high demand for rentals and used equipment.

On the M&A front, we are pleased to announce the closing of the Trackless acquisition in April. Trackless is a leading Canadian manufacturer of multipurpose off-road municipal tractors and a variety of attachments, which provide year-round value to its customers. The Trackless integration is well underway, and we are excited about the opportunities to leverage our 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 growth.

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 first quarter performance, our record backlog, and improving supply chain conditions, we are raising our full year Adjusted EPS outlook to a new range of $2.21 to $2.43 from the prior range of $2.15 to $2.40. We are also increasing the low end of our full year net sales outlook range by $40 million, establishing a new range of $1.62 billion to $1.72 billion.

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

**Operator**

We will now begin the question-and-answer session. (Operator Instructions) Our first question comes from Chris Moore with CJS Securities. Please go ahead.



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**Jennifer Sherman**

Morning, Chris.

**Chris Moore**

Hey, good morning. Great quarter.

**Jennifer Sherman**

It is a good morning.

**Chris Moore**

Yes, it's right. Maybe start with backlog and just maybe your thoughts in terms of the pricing of your backlog today versus six months or 12 months ago, when you factor in things like year-to-date seal increase, there's -- obviously, freight costs are changing, some improving. Just kind of your thoughts on how that backlog sits today from a pricing perspective.

**Ian Hudson**

Yes. I think, Chris, obviously, last year, we took a series of pricing actions in response to the inflationary environment that we saw at that time. We feel pretty good about the pricing of the backlog. I think if you look at the margin improvement, price was a factor in driving some of that improvement. We also had increased sales volumes and some nice operating leverage within both our groups, but price was a factor. I think overall, where we sit today, Chris, I think we feel comfortable with the pricing of the backlog.

**Chris Moore**

Got it. Record orders, record backlog, what's your sense of kind of customer perception regarding lead times? Do they feel less need at this point in time to preorder than they might have this time last year?

**Jennifer Sherman**

Yes. We look carefully at the order trends across the business. One of the things that was notable was that we saw strong orders on both the industrial and municipal side. We still continue to have challenges on the dump body side of the business because of the limited chassis availability, particularly for Class 5 chassis that impact a couple of our businesses. Overall, we're still expecting strong orders in Q2, although sequential and year-over-year comparisons may be distorted kind of given the size of the backlog.

**Ian Hudson**

I think, Chris, we are actively trying to work down some of those lead times. That's one of the things we cited on our prepared comments was just the increased production levels that we've seen at both of our Vactor and Elgin facilities. That's the second quarter in succession where we've seen meaningful improvement in production levels, and that's encouraging that we're seeing some improvement on the supply chain there. I think, overall, we are trying to work down some of those lead times.

**Jennifer Sherman**

I'll just add there. We're very focused on trucks per day, and kind of building on what Ian said, we saw 17% sequential improvement. We are really encouraged at our largest facility, if you just look at that particular



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facility, we saw a 22% sequential improvement. Very focused on reducing the lead times but encouraged by the order trends we're seeing.

**Chris Moore**

Got it. That's very helpful. I'll leave it there. Thanks, guys.

**Ian Hudson**

Thanks, Chris.

**Operator**

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

**Ian Hudson**

Good morning, Mike.

**Mike Shlisky**

Hey, good morning, and thanks for taking my question. I actually want to pop on your last answer, or maybe it was two questions ago, about the chassis comment for dump bodies. Because you have mentioned, Ian, during your prepared comments that you had a chassis headwind in the quarter. It sounded like there was a headwind that implies a positive mix for dump bodies. In other words, having more chassis positive for the dump body business, I would imagine. Can you square those two up? Did you have better chassis supply in this quarter or worse?

**Ian Hudson**

When we talk about chassis, Mike, two separate kind of groups, I would say, is that we never provide the chassis for the dump truck business, the customer always provides a chassis. In the prepared comments, what we were talking about was the other side of the business where historically, we've had about a 50-50 split, where 50% of the time we provide the chassis, 50% of the time the customer provides the chassis.

In the last couple of—last year or two, we've actually increased the amount of chassis that we supply because we've had pretty decent access to chassis. We've been able to provide those to our customers. We have made some strategic investments in procuring chassis on behalf of our customers. What that means from a margin standpoint, is we don't make much of a margin on those chassis. It's more of a pass-through.

That has, as we increase the chassis revenue, that can be a drag on gross margin and EBITDA, and that was what we cited in our prepared comments, that year-over-year, the increase in the chassis revenue where we are supplying more of the chassis, that caused a headwind year-over-year about 40-basis points on EBITDA margin. It's not necessarily linked to the dump body business.

**Mike Shlisky**

Okay. It's just mix. That's really…

**Ian Hudson**



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Correct.

**Mike Shlisky**
All it is.

**Ian Hudson**

Mix with more chassis revenue for more chassis that we provide.

**Mike Shlisky**

Perfect. Thank you.

**Jennifer Sherman**

I've got a different way. I mean, the business, our chassis revenue was up $12 million year-over-year, and that had, as Ian pointed out, a drag.

**Mike Shlisky**

Got it. My next question I can ask this in two different ways. I'll just pick one. The SSG margins were very strong. That's really solid. It's already towards the high end of the range you just put out a few months ago. Are you already thinking about maybe even an additional range higher from here, given what you've learned? Or I guess, what could go wrong from here in that segment to not go towards the high end of the range that you just put out in the foreseeable future?

**Jennifer Sherman**

Look, we are really encouraged by SSG's performance. As we've talked about on previous calls, they were a couple of quarters ahead, we've seen in kind of supply chain improvement. I spent some time on the call talking about some of the in-sourcing that we've done, which has made a difference out there. They also had a large fleet order, which helped them during the quarter. We're confident that they'll continue to operate within that range. It can fluctuate quarter-to-quarter, but we're really encouraged by what we saw in Q1.

**Mike Shlisky**

Okay. Fair enough. Maybe one, last one for me. I just wanted to ask about the dealer network. Given the higher interest rates we're seeing out there for floor plan or inventory type lending or even just lending in general, are any of your dealers experiencing any challenges finding adequate financing at decent rates? Is that affecting anyone's inventory decisions? Then maybe secondly, are there any dealerships that are potentially experiencing financial distress at the moment?

**Jennifer Sherman**

Yes. A couple of things. One is we have several large dealers that are very well financed and very well capitalized. In addition to that, given the amount of public funding that's available for our products, that's been a positive tailwind. The short answer to your question is, we really haven't seen any issues with respect to our dealer network and we monitor it closely. We're very fortunate to have well-financed dealers.

**Mike Shlisky**

Outstanding. I'll leave it there. Thank you so much.



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**Ian Hudson**

Thanks, Mike.

**Operator**

Our next question comes from Felix Boeschen with Raymond James. Please go ahead.

**Jennifer Sherman**

Good morning, Felix.

**Felix Boeschen**

Hey, good morning, Jennifer, Ian. I appreciate the comments on the 17% sequential improvement in output at your two biggest facilities. I did note that ESG sales were down just a bit quarter-over-quarter. Can you maybe square that away for us just sort of what worked against you? Maybe you could also comment just how much the production for in-house rental equipment might have impacted revenue or EBIT within ESG?

**Ian Hudson**

Felix, you're talking sequentially?

**Felix Boeschen**

Yes.

**Ian Hudson**

Yes. I think aftermarket was a piece of that. There is less aftermarket business in Q1 versus Q4. The other piece would be, as you pointed to, was just the production of the units in the rental fleet. We added about, I think it was about $18 million gross into the rental fleet during Q1. We wouldn't have been putting any of that really in the fleet during Q4. That's probably the biggest factor. We also had a bit of a step down at TBI with the chassis supply situation, versus Q4, that was down a little bit in Q1.

**Felix Boeschen**

Got it. Super helpful. Then how do you feel about the rental size today, just relative to the opportunities you're expecting sort of into the back half of the year and presumably into 2024?

**Jennifer Sherman**

Given the lead times that we're experiencing, rental demand continues to be strong. Also, we're seeing several contractors, as they bid and execute on some of these public funding through the Infrastructure Act, supplement their fleet through rental. We're very encouraged by what we're seeing.

**Felix Boeschen**

Got it. Then just maybe if I could, my last one, Jennifer, if you don't mind giving some more color around maybe specific vehicle locations? I'm curious how orders in TBI is holding up versus maybe some of their municipal centric locations?



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**Jennifer Sherman**

Yes. We focused on OX BODIES, and we gave the example in terms of what the 80/20 improvement initiative could do, and that's a good example of—they're sitting on record backlog. In addition to that, where we're seeing some softness is really on the Class 5 chassis side of things. Two of our businesses are reliant on Class 5 chassis, and those are down year-over-year. That's where we've seen some softness. Across the rest of the enterprise—excuse me, and the dump body side things we're seeing various puts and takes, depending on what chassis availability is.

**Ian Hudson**

Yes. I think, Felix, if you look at the breakdown, municipal was up 11% year-over-year. A lot of that is driven by strength in street sweeper orders, which is tied to some of the funding, as Jennifer mentioned, the American Rescue Plan Act. I think we talked about the fact that Q1 of last year was the prior record in terms of the highest order. Even when we're comparing Q1 of this year to Q1 of last year, that was a pretty strong comp.

Even with all of that, we didn't see a major drop-off year-over-year in any product line. The largest product line that was down year-over-year was probably the dump truck, which was down about $11 million year-over-year in terms of orders, and that's about 15%. Even with that order intake, it was still at a pretty good level.

**Felix Boeschen**

Got it. Really appreciate the time.

**Ian Hudson**

Thanks, Felix.

**Jennifer Sherman**

Thanks, Felix.

**Operator**

(Operator instructions) Our next question comes from Steve Barger with KeyBanc Capital Markets. Please go ahead.

**Jennifer Sherman**

Good morning.

**Steve Barger**

As I think about your focus on trucks per day, your guidance increase, and your existing capacity, presumably this will be the low quarter for ESG revenue. I'm wondering, do you expect that revenue will be fairly level quarter-to-quarter for the rest of the year as you build to these really strong demand levels?

**Ian Hudson**



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Yes. Steve, I think we'll see in Q2 and Q3, those tend to be strong because of the aftermarket business, we would expect that to pick up. I think we'd expect Q3 to be our highest for the year in terms of both revenue and EPS. That's primarily driven by the strength in the aftermarket business because you have three solid months of a lot of activity. I think our cadence would be—to your point, Q1, we would expect to be the lowest, then we'd see a step-up in Q2. Then Q3, we would expect that to be the high point. Then Q4 is always relatively strong, but we would expect Q3 to be kind of the highest quarter of the year.

**Steve Barger**

Presumably, you wouldn't expect to see a significant drop off in Q4, just even as aftermarket goes away. If supply chain has improved, given your backlog, you'd be running at high capacity, right?

**Ian Hudson**

Right, yes.

**Jennifer Sherman**

Agreed.

**Steve Barger**

Okay. Your M&A strategy has obviously been focused on bolt-on deals serving good niches. As you think about the funding environment and the visibility out there, is that driving deal multiples higher? Are you changing how you think about multiples? What looks reasonable, just given how you see growth and your ability to leverage the dealer network?

**Jennifer Sherman**

It all depends on the synergy numbers and we're pretty conservative when we developed those numbers. Again, we've seen multiples actually come down over the last year. I think a combination of the pandemic and supply chain challenges, particularly in the markets, the primary transactions we're looking at, we've seen more reasonable market multiples.

We've also candidly, we talked about in the last call, we have a number of sellers that have come to us and said, we want to sell to Federal Signal, which we've developed a pretty good reputation in the marketplace as being a preferred buyer.

**Steve Barger**

Yes. Okay, good. Then last quarter, you talked a bit about higher-than-normal investment in the lease fleet and allocating the production capacity to that. With demand this strong, are you more inclined to keep third-party customers happy or to make that lease fleet investment? How are you going to balance that as supply chain improves and you work to reduce lead times?

**Ian Hudson**

Yes. I think Steve, the heavy investment for the year was really during Q1 and the reasons for that is really you want to have the units added to the rental fleet come, April, May time, just when the season kind of starts picking up. I think the heavy sense of production was during Q1, and that's one of the factors why Q1 is our lowest in terms of revenue and EPS. There may be some incremental investment as we go throughout the course of the year, but I think Q1 is when the bulk of that takes place.



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**Jennifer Sherman**

We're very focused on reducing those lead times with increasing unit production.

**Steve Barger**

Right, yes. That generates, obviously, better revenue, but also good operating leverages as you offset the absorption?

**Jennifer Sherman**

Volume matters.

**Steve Barger**

Yes, great. Thank you.

**Jennifer Sherman**

Thank you.

**Ian Hudson**

Thanks, Steve.

**Operator**

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

**Walter Liptak**

Hi, thanks. Good morning, guys, and…

**Jennifer Sherman**

Good morning, Walt.

**Walter Liptak**

I wanted to ask first about the SKU reduction in OX BODIES was really interesting. It's great to see, just hear the story about 80/20 work that's happening. The question I have is about, is this an initiative that's been ongoing, and you just decided to call this one out? Or is there more of an effort to bring 80/20 to some of the newly acquired businesses?

**Jennifer Sherman**

Yes. A couple of things, Walt. This was just one example of many. Our OX team has done such a good job. What I really was trying to message is we come out of this pandemic supply chain, our teams, there's a refocused effort on 80/20 across the enterprise. I think what's important also to note is it's such a part of our culture that we've hired a dedicated individual as part of the corporate team now that is working with



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each of these businesses on these 80/20 type projects. We believe that will be a driving factor in our margin improvement as we go forward.

**Walter Liptak**

That's great. Good to hear. I want to do a follow-up on the selling prices and inflation. I wondered, are you seeing—there's kind of a mix out there of some inflation and some material costs coming down. I wonder if you could just comment on where you're seeing inflation in 2023 and where are selling prices going? Are you able to get price kind of across the board? Or are there some products where pricing is a little bit more difficult?

**Jennifer Sherman**

We've seen, like many companies, wage inflation. In addition to that, steel, we've seen that come down some, depending on the type of steel that you're talking about. That can vary month to month. We have a large percentage, we talked about before, of our steel fixed. As we move forward on price, that is something that it depends business to business, and each one of our businesses monitor end market conditions. We've been successful at price increases across the businesses as reflected in the numbers.

**Walter Liptak**

Okay, great. Then maybe a last one, just another follow-up. You commented that some of the multiples are a little bit lower. I wonder if you had a thought about why. It's great that some multiples are coming down, and I wonder if you have a thought about why is that? Are there more private equity funds that are liquidating to raise capital? Why do you think multiples are coming lower?

**Jennifer Sherman**

I think the interest expense and the impact interest rates have on private equity models plays an important role in the types of transactions that we're looking at. In addition to that, as we've talked about before, as we do more and more acquisitions, we've become more of a preferred buyer. With many of our transactions, it's not all about price. It's about much more than price.

I think that I'm proud of the reputation that our teams have developed with respect to M&A and the execution and integration. I think that will benefit us long-term as we've seen in some of the transactions that we've recently done. Trackless is a great example.

**Walter Liptak**

Okay. That sounds great. Thanks very much.

**Operator**

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

**Dave Storms**

Thank you and good morning.

**Jennifer Sherman**

Good morning.



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**Ian Hudson**

Good morning, Dave.

**Dave Storms**

With regards to the production improvements that you've mentioned a lot, can you break that out in terms of, is that driven by supply chain improvements? Is that driven by the operational improvements through the 80/20 initiative that you've talked about? How much runway do you see left there?

**Jennifer Sherman**

Yes. We've seen obviously some supply chain improvements, and that's been a critical driver. The teams are—there's been a refocus, as I mentioned earlier, as we've gotten out of the nightmare of pandemic and supply chain on our 80/20 initiative. We've seen benefits of that at various businesses across the enterprise.

We continue to believe we're kind of back to, as we talked about, our businesses we're back to that kind of Q1 of 2020 type unit production levels at a couple of our businesses, but there's still room for more. We invested in our expansion of our largest facility, and we still believe there's more opportunity for margin expansion as supply chain improves. We're excited about those opportunities.

**Dave Storms**

Very helpful. Thank you. Then, Ian, you mentioned an increased demand in rentals that you expected through the rest of the year. Do you see this coming at the expense of sales or in concert with grown sales? Then also, any relation that has to any aftermarket sales through the rest of 2023?

**Ian Hudson**

Yes. No, I think we're expecting strong demand for all of our product offerings. I think if you look at the contribution of aftermarket, it was about 27% of ESG's revenues in Q1. That was about the same level as Q1 of last year and also for the whole of last year. I think our growth on the new equipment side has been keeping pace with the growth that we've seen in aftermarket. That's what we'd expect.

I think with lead times where they're at, I think having the offerings that we have where we can offer used equipment sales and rentals, that positions us really well to serve our customers. I think as we think about the potential for the Infrastructure Bill on the various projects, having the ability to sell new, to provide rentals, to sell used, I think that positions us really well.

**Dave Storms**

That's very helpful. Thank you.

**Operator**

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

**Jennifer Sherman**



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In closing, I'd 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. We would like to express our thanks to our stockholders, 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.



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