



Federal Signal Corporation

Second Quarter 2024 Earnings Conference Call

July 25, 2024

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PRESENTATION

Operator

Greetings, and welcome to the Federal Signal Corporation's Second Quarter Earnings Conference Call. At this time, all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. If anyone should require Operator assistance during the conference, please press star, zero on your telephone keypad. As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Felix Boeschen, Vice President, Corporate Strategy and Investor Relations. Thank you, Felix. You may begin.

Felix Boeschen

Good morning, and welcome to Federal Signal's second quarter 2024 conference call. I'm Felix Boeschen, the Company's Vice President of Corporate Strategy and Investor Relations. Also with me on the call today is Jennifer Sherman, our President and Chief Executive Officer; and Ian Hudson, our Chief Financial Officer. We will refer to some presentation slides today as well as to the earnings release which we issued this morning. The slides can be followed online by going to our website, federalsignal.com, clicking on the Investor Call icon and signing into the webcast. We have also posted the slide presentation and the earnings release under the Investor tab on our website.

Before we begin, I'd like to remind you that some of our comments made today may contain forward-looking statements that are subject to the Safe Harbor language found in today's 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. GAAP 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.

Ian will start today by providing details on our second quarter financial results. Jennifer will then provide her perspective on our performance and update on our multiyear growth outlook and our updated guidance for 2024. After our prepared comments, we will open the line for any questions.

With that, I would now like to turn the call over to Ian.

Ian Hudson

Thank you, Felix. Our consolidated second 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 organic net sales and earnings growth, gross margin expansion and a 280 basis point improvement in EBITDA margin. Consolidated net sales for the quarter were \$490 million, a record high for the Company and an increase of \$48 million or 11% compared to last year. All of the growth this quarter was organic.

Consolidated operating income for the quarter was \$81.1 million, up \$21.7 million or 37% compared to last year. Consolidated Adjusted EBITDA for the quarter was \$97.7 million, up \$22.2 million or 29% compared to last year. That translates to a margin of 19.9% in Q2 this year, up from 16.1% in Q2 last year. GAAP EPS for the quarter was \$0.99 per share, up \$0.33 per share or 50% from last year. On an adjusted basis, EPS for the quarter was \$0.95 per share, up \$0.28 per share or 42% from last year.

Order intake for the quarter was again strong with second quarter orders of \$473 million, contributing to a backlog of \$1.08 billion at the end of the quarter, an increase of \$73 million or 7% compared to Q2 last year.

In terms of our group results, ESG's net sales for the quarter were \$409 million, up \$36 million or 10% compared to last year. ESG's operating income for the quarter was \$72.9 million, up \$16.7 million or 30% compared to last year. ESG's Adjusted EBITDA for the quarter was \$88.2 million, up \$17.5 million or 25% compared to last year. That translates to an Adjusted EBITDA margin for the quarter of 21.6%, an improvement of 260 basis points compared to last year and performing towards the upper end of our current target range. ESG reported total orders of \$396 million in Q2 this year compared to \$409 million last year.

SSG's net sales for the quarter were \$82 million this year, up \$12 million or 18%. SSG's operating income for the quarter was \$18.3 million, up \$4.2 million or 30% compared to last year. SSG's Adjusted EBITDA for the quarter was \$19.3 million, up \$4.1 million or 27%. That translates to a margin of 23.7%, above SSG's current target range and up 180 basis points compared to last year. SSG's orders for the quarter were \$77 million, an increase of \$5 million or 7% compared to last year. Corporate operating expenses for the quarter were \$10.1 million, down from \$10.9 million last year.

Turning now to the consolidated income statement, where the increase in sales contributed to a \$26.7 million improvement in gross profit. Consolidated gross margin for the quarter was 29.4%, a 290 basis point increase over last year. As a percentage of sales, our selling, engineering, general and administrative expenses for the quarter were down 20 basis points from Q2 last year. Other items affecting the quarterly results include a \$200,000 increase in acquisition-related expenses, a \$100,000

reduction in amortization spend, a \$700,000 decrease in other expense and a \$2.4 million reduction in interest expense.

Tax expense for the quarter was \$16.7 million, up \$4.3 million from the prior year. Our effective tax rate in Q2 this year was 21.5% compared to 23.5% last year, with the reduction primarily due to a \$2.6 million discrete tax benefit recognized in connection with the amendment of certain state tax returns to claim a worthless stock deduction. At this time, we expect our effective tax rate for the remaining half of the year to be between 25% and 26%, excluding any additional discrete tax benefits. On an overall GAAP basis, we therefore earned \$0.99 per share in Q2 this year compared with \$0.60 per share—\$0.66 per share in Q2 last year.

To facilitate earnings comparisons, we typically adjust our GAAP earnings per share for unusual items recorded in the current or prior year quarters. In the current year quarter, we made adjustments to GAAP earnings per share to exclude acquisition-related expenses and the discrete tax benefits I previously mentioned. On this basis, our adjusted earnings for the quarter were \$0.95 per share compared with \$0.67 per share last year.

Looking now at cash flow. We generated \$41 million of cash from operations during the quarter, an increase of \$5 million from Q2 last year. That brings the total cash generated from operations in the first half of this year to \$72 million, an increase of 67% over the first half of last year. We ended the quarter with \$207 million of net debt and availability under our credit facility of \$533 million. Our current net debt leverage ratio remains low.

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 opportunities to take share repurchases. On that note, we paid dividends of \$7.4 million during the quarter, reflecting a dividend of \$0.12 per share. 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. Our second quarter results represent another outstanding quarter as our team set quarterly performance records across many metrics in the net sales, EBITDA margins and adjusted EPS, all while maintaining a healthy order intake.

Within our Environmental Solutions Group, we were able to deliver 10% year-over-year net sales growth and a 25% increase in Adjusted EBITDA, with increased production at several of our businesses and continued price realization representing meaningful year-over-year drivers. Overall, in what is typically a seasonally strong quarter, ESG's Adjusted EBITDA margin was up 260 basis points year-over-year.

We were particularly encouraged with the progress we have made across the enterprise on our build more trucks initiative this quarter. Our dump truck body businesses had another strong quarter, with sales up 22% on the back of improving chassis availability and higher build rates. The increased dump truck body production, coupled with our ongoing 80/20 initiatives at several key facilities, was again a contributing factor in our year-over-year margin improvement within our ESG segment.

In fact, monthly chassis receipts at our Ox Bodies facility grew sequentially throughout the quarter, with June chassis deliveries the highest experienced since the first quarter of 2021. We remain focused on maintaining our industry-leading lead times in this space as we raise our production levels.

Our strategic dump truck growth initiatives are also gaining momentum. Ox Bodies is broadening its geographic reach in key states such as Texas. The Rugby team is progressing along its 80/20 journey in the form of product and SKU simplification. Switch-N-Go is on track to start production of its new Class 3 interchangeable multibody product in August. The Switch-N-Go Class 3 product launch provides customers additional flexibility in what remains a constrained medium-duty chassis environment.

At our largest manufacturing facility in Streator, production increased by 15% year-over-year, including the \$13 million of sewer cleaner shipments that were affected by the third-party component supply issue that we experienced in March. MRL, our road marking and line removal business, is also benefiting from improving supply chain conditions and a constructive demand backdrop as the team was able to drive a 29% year-over-year increase in sales.

In addition to anticipated multiyear benefits stemming from the infrastructure bill, we are also seeing ongoing shift towards early autonomous vehicle functionality and the addition of smart features for passing cars as a key long-term driver of road striping demand. Big picture, while supply chain performance has not yet fully recovered to prepandemic levels, supply chains are consistently improving for our family of specialty vehicle businesses.

This improvement in supply chain should, over time, allow us to drive additional output and gain manufacturing efficiencies as we aim to reduce lead times for certain products, including vacuum trucks and street sweepers. From a capacity perspective, our access to labor remains good and our large-scale capacity expansions that we completed between 2019 and 2022 position us well to profitably absorb incremental volumes into the current facility footprint.

Shifting to aftermarkets, activity levels remained strong across our offerings. Performance was led by increase in part sales, service rental and rental income, partially offset by lower used equipment sales, as our teams are working diligently to balance rental unit availability and used equipment sales to best serve our customers. In short, rental utilization and demand for our rent-to-own equipment offerings remains high.

From a strategic perspective, our growing aftermarket ecosystem allows us to better serve our customer needs throughout the entire business cycle. Especially in the higher interest rate environment that we are experiencing today, the option to rent new or acquire used pieces of equipment represents an important alternative for many of our industrial customers to access equipment in a timely and affordable manner.

As we continue to scale our aftermarket business, we see additional long-term growth opportunities. As acquired businesses are integrated into the platform, we further increased our parts capture rate, optimize underserved regions and address non-traditional Federal Signal customer cohorts through our rent-to-own service offerings. In total, aftermarket represent approximately 25% of ESG revenue in the second quarter of 2024.

Shifting to our Safety and Security Systems Group. The team delivered another quarter of outstanding results with 18% top line growth, a 27% increase in Adjusted EBITDA and a 180 basis point improvement in Adjusted EBITDA margin on the back of sales volume increases and price realization. Sales of public safety equipment paved the way with 25% year-over-year growth as our lightbars and sirens products are resonating in the marketplace. This strong underlying demand for our products, coupled with the insourcing investments we've made in recent years and our ongoing 80/20 efforts, have contributed to achieving a mid-teens year-over-year improvement in volumes.

Going forward, our teams remain energized to continue to execute on a robust NPD pipeline across all of our SSG businesses as we aim to fortify and grow our position as the industry leader of audible and visual safety equipment. We have also been pleased with our cash generation through the first half of the

year as cash generated from operations rose 67% compared to last year. On an annual basis, we continue to target 100% cash conversion levels.

Another highlight of the quarter included the publication of our latest sustainability report. 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 operate sustainably with a long-term positive impact to 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.

The report also highlights the progress we have made against our sustainability goals that were initially established in 2018. Having achieved our electricity, water and CO2 intensity reduction goals early, we have announced our new 2030 energy intensity reduction goals.

Shifting now to current market conditions. Demand for our product offerings and services remains high; with our second quarter order intake of \$473 million just falling short of last year's record second quarter orders of \$480 million. For comparison purposes, please note that last year's orders included approximately \$8 million of acquired backlog from the Trackless acquisition.

In recent years, we have supplied a higher concentration of chassis than our customers. As chassis availability has improved, customer buying patterns have started to revert to the more typical 50-50 split that we have historically experienced. This shift resulted in nine million fewer chassis orders in Q2 this year compared to last year. This trend is also expected to represent a year-over-year net sales headwind of approximately \$10 million in the second half of the year but should have some nominal margin benefits.

The composition of orders remains balanced between our publicly funded and industrial end markets, as contribution from both subsets were similar on a year-over-year basis. On the publicly funded side, demand for our flagship sewer cleaners has remained consistently high throughout 2024 on the back of solid core funding mechanisms. Our SSG business is experiencing a similarly stable growth pattern as orders increased 7% in the quarter. This includes a \$6 million public safety equipment order from a major municipality slated for delivery in 2025.

Lastly, resulting from our ongoing end customer and market diversification efforts, our dump truck body business enjoyed double-digit order growth with municipal customers in the second quarter. On the industrial side, orders for dump truck bodies continue to lead the charge with orders up 32% year-over-year.

Similar to last quarter, we believe this to be driven by a combination of pent-up replacement demand, execution on our strategic initiatives across different end markets and high current equipment utilization levels. We are also seeing strong demand for our metal extraction support equipment as we are starting to reap distribution benefits from the combined Ground Force and TowHaul platform.

Lastly, our teams remain laser-focused on positioning our businesses to be able to capitalize on projects resulting from the \$550 billion Bipartisan Infrastructure Bill. Although we believe the opportunity still remains in its early stages today, we anticipate many of our special vehicle offerings to participate in an array of projects and, importantly, at different stages of projects.

As an illustrative example, while we expect use of dump trucks to be fairly consistent throughout the life of a project, we expect road marking or street sweeping demand to be weighted more heavily towards the end of a project when a new road that's marked for projects are cleaned. In fact, we have seen some examples of dump truck orders tied to early infrastructure projects, including a multi-unit order for a highway construction project in the Southwest that we booked this quarter.

We are also encouraged with early feedback we've received on our Guzzler microtrenching vacuum truck which is ideally suited for the installation of broadband infrastructure. Our teams will be showcasing our Guzzler microtrencher at the upcoming Fiber Broadband Association show. In summary, demand for our products remain strong and our teams are focused on executing our growth initiatives and building more trucks, while continuing to maintain a healthy order intake.

I now want to take a few minutes to provide an update on our through-the-cycle revenue targets and growth initiatives. While we have historically talked about a high single-digit annual revenue growth target, we are officially raising the bar to a low double-digit annual growth target which is roughly consistent with our actual track record since 2016. Achieving that growth will be multifaceted as we expect low to single—low to mid-single-digit base level and market growth to be supplemented by outsized growth from our organic initiatives and contribution from M&A.

In fact, we see opportunities for several businesses to expand their geographic reach as we start to harness the increasing benefits of the power of our growing specialty vehicle platform with our aftermarket operations at the heart of that value proposition. An excellent example of that platform power is the 30% year-over-year growth we achieved at Trackless in the first year of Federal Signal ownership. We also see these platform benefits fueling other strategic growth initiatives, including new product development, aftermarket support, sales channel and procurement optimization.

Shifting to inorganic growth. Our M&A pipeline remains active with several opportunities currently under evaluation. In line with our M&A strategy set forth in 2016, we are primarily focused on three types of acquisition opportunities. First, identifying new market adjacencies to penetrate within our ESG and SSG segment. Second, opportunistically adding to verticals in which we already operate. Finally, acquisitions to further accelerate our aftermarket growth.

We remain rigorous and vigorous, in our due diligence processes as we aim to identify the right strategic additions for Federal Signal. We believe our track record, integration process, modest debt profile and strong free cash flow generation all position us as an acquirer of choice in our markets.

Lastly, as we indicated, we were pleased with our margin performance in the quarter with performance towards the upper end of our current target range. Recall, our stated margin targets are meant to be annual and through-the-cycle targets. When we last raised our targets on our third quarter 2023 earnings call, we outlined four foundations supporting the raise, including, leveraging our capacity expansions, the rollout of our codified Federal Signal operating system, continued growth in our aftermarket business and value-added M&A.

At Elgin, our pilot plant for the rollout of our recently codified Federal Single operating system, we saw some initial productivity and cost optimization benefits associated with this initiative in Q2. We are pleased with the progress we've made on a number of these foundations through the year at many of our businesses, but we are not done here. We see ourselves as being in the early innings in what we view as a multiyear opportunity to drive structural improvement.

Turning now to our outlook for the rest of the year. Demand for our products and our aftermarket offerings remains high, with our strong order intake this quarter contributing to a backlog which provides us with excellent visibility into the second half of the year. With our second quarter performance, our current backlog and continued execution against our strategic initiatives, we are raising our full year adjusted EPS outlook to a new range of \$3.20 to \$3.35 from the prior range of \$2.95 to \$3.15. We also reaffirming our full year net sales outlook of between \$1.85 billion and \$1.9 billion.

This outlook which does not assume any M&A, reflects our view of continued healthy demand for our new equipment, parts and aftermarket services and also assumes a continuation of daily build rate increases at several key facilities, somewhat offset by fewer production days in the second half of the year.

We also continue to expect double-digit improvement in pre-tax earnings and EBITDA margin performance in the upper half of our target range. Lastly, we are maintaining our CapEx outlook of \$35 million to \$40 million for the year.

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

Operator

Thank you. We will now be conducting a question-and-answer session. If you would like to ask a question, please press star, one on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star, two if you would like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star keys. One moment, please, while we pull for questions.

Thank you. Our first question comes from the line of Steve Barger with KeyBanc Capital Markets. Please proceed with your question.

Steve Barger

Thanks. Good morning.

Jennifer Sherman

Good morning, Steve.

Steve Barger

Really strong quarter. I wanted to start with the ESG incremental...

Jennifer Sherman

We agree.

Steve Barger

Yes. I want to start with the ESG incremental margin of 46%, following 40% in the first quarter. Can you talk through volume, mix and price? And, just what do you expect for incrementals in the back half?

Ian Hudson

Yes. Steve, I think as we look kind of the breakdown on the top line, volume, that was 8% of the 10% growth. Price was about 2.5%. We had a little bit of a headwind from fewer chassis, I think Jennifer talked about that impact, so that was about a 1% drag on the top line there. As we think about kind of the drivers of the margin improvement, volume was the biggest driver of that and just the efficiencies that we get from ramping up production in several of our facilities. We did have favorable price cost dynamics in the quarter. That was also a factor.

And then the other thing is we have the aftermarket business, as well as some of our recent acquisitions which have a slightly more attractive margin profile. As those businesses have grown, that's pulled up kind of the overall average and so that's had some margin benefits as well. As we think about kind of the back half of the year, I think the guidance that we've given would indicate that we're still expecting incrementals for ESG to be kind of north of 30%. That's kind of what's implied in the outlook.

Steve Barger

Yes, for sure. If I model to the high end of the new guidance, the quarters in the back half will certainly have good margins but will run maybe \$0.07 to \$0.08 lower than what you just put up. Is mix getting worse? Is it holidays? Can you talk about why \$0.95 isn't a sustainable run rate given the backlog and the capacity you have?

Ian Hudson

Yes. A couple of things that I think Jennifer alluded to, the fewer production days that we have in the second half of the year versus the first half of the year. That's kind of always something that we face in the second half of the year. There's a couple of others. We talked about the chassis impact, the \$10 million that will impact the top line. That won't be much of an earnings impact because it's typically passed through. That should have a little bit of a lag benefit there.

And then just the other thing to remember, as we talked on our last earnings call about some incremental rental fleet investment that we were making, most of that is in the second half of the year. That will also be a factor.

Steve Barger

And sorry if I missed this, what's the difference in production days between the first half and the back half?

Ian Hudson

I think we're in kind of the six to seven range.

Steve Barger

And, did you say what the incremental investment in rental is?

Ian Hudson

So, this was on our first quarter call, we talked about a \$20 million incremental fleet investment. That will have some impact, with most of that being in the second half of the year. That's nothing new. That's the same as what we talked about in Q1.

Steve Barger

Understood. Yeah. Thank you.

Jennifer Sherman

Thank you.

Operator

Our next question comes from the line of Walt Liptak with Seaport Research. Please proceed with your question.

Walter Liptak

Hi, good morning guys. Great quarter.

Jennifer Sherman

Good morning.

Walter Liptak

I wanted to ask about the dump truck orders were very strong. It's nice to see that recovery happening. I think that's the second or third quarter in a row. I wonder if you could talk a little bit about the cadence of orders. I think you kind of alluded to some of this in your—Jennifer, in your presented comments. Are those—I mean, at what point do you start getting into tough comps? Do you see sort of this pent-up demand giving way to sort of a normalized growth rate? How should we think about the second half for dump truck ordering?

Jennifer Sherman

Yes, neat. First of all, we were pleased with orders overall. As we noted on the call, dump truck orders were strong. I think that was—it is a combination of execution on strategic initiatives, particularly some of the geographic expansion issues initiatives. Initiatives that the teams have done a really nice job. There's pent-up demand. Chassis improvement. We talked about during this quarter, Ox Bodies; we saw kind of the highest number of cases available that we've seen for several years. Then finally, there's pent-up demand.

And then we're starting—we have some examples that we cited one on the call of benefits from infrastructure. Their lead times are much shorter than, for example, right now, sewer cleaners and certain street sweepers. We're able to, for many of those orders, slip those orders when the order comes in and we're able to deliver it within the quarter. The other thing that was encouraging on the dump truck order side is it was pretty balanced between municipal and industrial.

Walter Liptak

Okay, great. It sounds like the order activity was good and kind of consistent during the quarter and you're feeling good going into the third quarter for order activity?

Jennifer Sherman

Yes, the order activity was consistent throughout the quarter. Really, accolades to the team for just strong performance and continued execution on the strategic initiatives.

Walter Liptak

Okay. Thanks for that. Going back to the production question. What are the pluses and minuses around you guys increasing the production in the second half? Because you got the backlog, that's there. It

sounds like the orders are coming in strong. Is it supply chain that's the biggest risk? Is it factory productivity? And, what could help you build more trucks in the second half?

Jennifer Sherman

So, I'll start with, again, we were really encouraged by what we saw in Q2. I'll start there. The teams did a really nice job in terms of building more trucks in many of our facilities. It can always vary business to business. Some of the critical considerations are we need to ramp and train labor. We generally have pretty good access to labor; we would hire and train them. Supply chain, always remains a factor. We've talked about chassis availability is pretty good.

The medium-duty chassis market continues to be tight. It represents a pretty small percentage of our overall business. We—the fewer production days in the second half of the year. Again, I want to emphasize, we would expect kind of gradual continued improvement as we work our way through the year because this is—the teams are razor-focused on reducing lead times at several of our facilities and increasing production rates.

Walter Liptak

Okay, great. Sticking with ESG, you made a comment that I hadn't heard before about autonomous vehicles and the MRL road striping. Is there something that's changed in that market? Or, are there like regulations or something or some funding for that? Or, is it just the product development that you're working on?

Jennifer Sherman

Yes. I think as more and more people have smart features on their cars that notify you, for example, when you're changing lanes and alert you, you need road striping, solid road striping to utilize those features. Our teams are out talking to customers and talking to agencies, having the ability to utilize those features that are in many of the automobiles we drive, continues to be an important part of the driver for our products.

Walter Liptak

Okay, great. Okay, I will get back in the queue. Thanks.

Jennifer Sherman

Thanks, Walt.

Operator

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

Christopher Moore

Good morning, guys. Another terrific quarter. No surprises.

Jennifer Sherman

Thanks, Chris.

Christopher Moore

Right. You've discussed rental. In many cases, the rent-to-own strategy really been helpful in this high rate environment, a differentiator. If rates come down a little this year, more in '25, is that going to have a meaningful impact on the aftermarket mix?

Jennifer Sherman

We believe, with the infrastructure bill, there's going to continue to be demand for rental products. This is particularly important to our industrial customers, particularly around safe digging. As product adoption of that particular product line increases, rental is often a format to try before you buy. I think, again, part of our strategy that we've talked a lot about is we're very flexible in terms of whether you want to buy new equipment, you want to rent equipment, you want to buy a used equipment at different price points, we can respond to all those various needs.

The other thing I'd point out is, as you know, 50% of our business is publicly funded which is really kind of immune to the interest rate environment.

Christopher Moore

Got it. Very helpful. You guys have done a really good job leveraging acquisitions into new geographies. You talked about Mark Rite and Trackless as an example. Are there any meaningfully underpenetrated geographies for any of your product lines at this point in time?

Jennifer Sherman

Yes.

Christopher Moore

Will you be...

Jennifer Sherman

Short question, did that answer it?

Christopher Moore

That's fair enough. I was hoping you'd get more specific but I also understand from a competitive standpoint...

Jennifer Sherman

Sure. No, I'm more than happy to give some examples. Like this room was cringing. Specifically, let's talk about dump trucks. We have geographic areas where we're the number one market provider. Part of the strategic initiatives of several of those dumb truck business is to extend that geographic reach. Number two is Trackless would be a good example. We've not fully optimized our go-to-market strategy. There are several geographies where Trackless doesn't really—does nominal sales of any.

And we're in the process by either leveraging our JJE footprint or pairing with other dealers to expand their geographic reach and it creates opportunities. We believe that Ground Force and TowHaul and the

optimization we've done our distribution, has allowed us to penetrate new geographies and we think we're at early stages there. Geographic expansion for many of our product lines is a critical strategic initiative.

Christopher Moore

Perfect. I will leave it there. I appreciate it guys.

Jennifer Sherman

Thanks, Chris.

Operator

Thank you. Our next question comes from the line of Ross Sparenblek with William Blair. Please proceed with your question.

Male Speaker

Hi, good morning. This is Sam (phon) calling on for Ross. Thanks for taking my question.

Ian Hudson

Good morning, Sam.

Jennifer Sherman

Good morning.

Male Speaker

So, the ESG segment backlog declined 1% from the first quarter. Can you talk about what this means for top line growth given that the ESG book-to-bill is less than one for the quarter? Is there a possibility that once you work through this backlog, that sales could be pressured?

Ian Hudson

Yes. I think, Sam, we've talked for several quarters now about trying to reduce lead times by increasing production while maintaining that healthy order intake level. I think that's really what we did this quarter. We were pleased with the order levels that we saw. Jennifer alluded to some of the comparisons and the fact that go into kind of the comparisons on the fact that it was down about 1% year-over-year. There was the Trackless backlog that was in last year's numbers, that was about \$8 million. Then there was also the chassis dynamics which was down \$9 million year-over-year. On a full year basis, we're expecting that chassis impact to have about a \$25 million impact on orders. That's something to consider as we go forward.

But, I think this was the first time that our sales had outpaced orders since the fourth quarter of 2020 and so that's resulted in some long lead times. That's why there is such a focus there on reducing those lead times, while maintaining the healthy order intake level. Just on the chassis, even though it's a \$25 million impact, that's largely pass-through revenue. From an earnings standpoint, it doesn't have much of an impact. It actually would likely have some margin benefits.

Male Speaker

Got it. That makes sense. Then kind of one follow-up. At 25% of ESG—or 25% of revenue, my math implies that aftermarket revenue was flat from the second quarter of '23, is that right? Am I thinking about it right?

Ian Hudson

It was up a little bit, almost—it was about 1.5%. It was up and this kind of the factors in. Net cost were up about 1%, they're up 6% year-to-date. Rental income was up 4% in the quarter, that's up 6% year-to-date. Then service was up 11% and that's about the same year-to-date. What was down is the used equipment sales. The issue there is because there is strong demand for used equipment and we saw strong sales in the fourth quarter of last year, there is a need to kind of replenish that fleet, because—but the timing of it is a factor.

Because we're going into—or we're in the middle of kind of peak rental season right now, so we want to make sure we hold—we're balancing, holding on to the units for the rental fleet, as well as satisfying customer demand for used equipment. That's one of the factors in that incremental fleet investment we talked about last quarter.

Jennifer Sherman

And I'll just add, particularly in this higher interest rate environment for our industrial customers, rental, for safe digging equipment in particular, is a critical option. We want to make sure we're in a position to be able to satisfy that strong rental demand.

Male Speaker

Got it. That make sense. I will leave it there.

Jennifer Sherman

Thank you.

Operator

Thank you. Our next question comes from the line of Mike Shlisky with D.A. Davidson. Please proceed with your question.

Michael Shlisky

Yes, hi. Good morning and thanks for taking my question.

Ian Hudson

Good morning, Mike.

Jennifer Sherman

Good morning, Mike.

Michael Shlisky

The backlog growth looks very solid here. Do you get the sense that even with the growth you're already seeing, are there folks who are waiting on the sidelines or after the election to kind of make any big decisions? And, maybe in the private sector, people in the oil and gas world, are they holding off? And, there could be an additional slug of orders to start 2025 here?

Jennifer Sherman

We haven't heard that. With respect to—we've seen only nominal benefits, as we talked about, from the infrastructure bill thus far. We would expect—it was bipartisan legislation, we would expect many of the projects—over 60,000 projects have been announced, we would expect those projects to continue regardless of the outcome in November. As we sit here right now, we haven't heard anything meaningful about the impact of the presidential election on our orders.

Michael Shlisky

Okay. I also certainly appreciate that you're bringing up your top line growth rate outlook for the long term through the cycle. Does that also—when you go into double-digit growth for top line, does that also kind of introduce on the margin side that you'll remain towards the upper end of your 2023 announced target? Or even potentially pull forward an increase in the margin targets in the not-too-distant future?

Jennifer Sherman

Yes. I think that we were pleased with the performance in Q2. We meaningfully increased the guidance range for the rest of the year. We believe that, as we've talked about before, the EBITDA margin targets we set are long term through the cycle. We'll continue to revisit those targets. With the various strategic initiatives, including our Federal Signal operating system and value-added M&A, we believe that there's further opportunity in the long run to increase those EBITDA margin targets as part of our planning. We're pretty bullish about the opportunities as we move forward.

Michael Shlisky

All right. Can you comment on the orders and backlogs as well for the quarter? How much pricing has driven the growth in each of those? It could just be on the full company basis, not by segment.

Ian Hudson

Yes. Price, Mike, is anywhere from 2% to 3%. That's kind of what we—I think we—at the beginning of the year, we guided to that on the top line, so that's also reflective of kind of the orders and the backlog; so yes, that's Q3.

Michael Shlisky

Great. I leave it there. Thanks so much.

Ian Hudson

Thanks Mike.

Operator

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

Gregory Burns

Good morning. When you look across your brand or product portfolio from an aftermarket perspective, are there some brands maybe, particularly with some of the newer acquisitions, that have a lower percentage of aftermarket sales? And, is there an opportunity there with maybe some particular brands to increase that?

And then longer term, do you have a target on where you want to take aftermarket sales to as a percent of revenue? I know it was that about 25% this quarter but do you have a targeted goal that you're hoping to achieve in terms of mix? Thanks.

Jennifer Sherman

Yes. Depending on the timing of the acquisition, we continue to stage the parts optimization throughout the FS Solutions and JJE platform and that's an important part of the synergies and the growth story. I think a really good example is the TowHaul and Ground Force acquisition. They've done a really nice job of collectively growing that particular businesses.

Our intention, as we just announced, is to both grow the overall business and aftermarket as a percentage of that business. Said another way, we want to grow both the numerator and the denominator. I think over time, you will see with several of the initiatives that we have in place, that the aftermarket business will continue to grow. We could see that—while still growing the denominator, we could see aftermarket business getting up to 30%.

Gregory Burns

Okay, great. Thank you.

Operator

Thank you. Our next question comes from the line of Dave Storms with Stonegate. Please proceed with your question.

Jennifer Sherman

Good morning, Dave.

David Storms

Good morning and congrats in the quarter. Just hoping we could get a breakout for the SSG margin performance similar to the ESG margin performance. Just curious if volumes are the main driver there as well.

Ian Hudson

Yes. Yes, Dave. Volumes were the main driver. If you think of the 18% top line growth, about 14% was volume. Then the rest would have been—price was about 3%, as we talked about and then there's some favorable mix components. The vast majority was the incremental volumes. And, I think as we've talked about previously, all of our domestic operations within the SSG business are in one facility. The more we can push through that facility, that has some pretty attractive drop-through. I think we saw some of that during the quarter.

David Storms

Very helpful. Thank you. Then I know you mentioned in your prepared remarks that given your strong cash position, you're excited about some organic growth initiatives. Any sense of what your prioritized list of organic growth initiatives would be? Is that increased capacity? Is that—just kind of what does that look like, performance uptake (phon)?

Ian Hudson

I mean kind of in our CapEx, we typically—I think we guided to \$35 million to \$40 million. That's typically about half maintenance, half growth. We look at things like lasers, robots, things that can generate some operational efficiencies. Those would be the types of things that we look at across the organization.

David Storms

Understood. That's very helpful. Thank you for taking my questions and good luck for the next quarter.

Ian Hudson

Thank you.

Operator

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

Steve Barger

Thanks. The multiyear growth target of double digit, do you expect organic growth in the future will run better than the historical 7% rate? Or, are you just kind of counting on that same number?

Jennifer Sherman

It can always vary quarter-to-quarter but we expect there to be strong organic growth as we continue to execute on these strategic initiatives.

Steve Barger

Well, just thinking about that, even if it is still 7%, it suggests you'll add maybe \$60 million plus per year in acquired revenue. Of course, that number will have to grow over time. Does the pipeline have enough depth of deals in progress that you expect at least one deal per year?

Jennifer Sherman

I believe we will have no problem hitting the numbers that you just stated. That pipeline is very full.

Steve Barger

As you think about the deals that are out there that you see, whether they close or not, what's the revenue average of those deals? And maybe the range? Is it from \$10 million to \$100 million? Or, what do you see?

Jennifer Sherman

Yes. The majority of the deals are in the \$50 million to \$100 million. There are a number of smaller deals and then there's always larger opportunities also. We've got a good—it's a pretty wide range but the majority of deals are in that \$50 million to \$100-ish million range.

Steve Barger

And, I know historically you don't like fixer-uppers, is that still the philosophy going forward? Do you—what's kind of the minimum margin profile that you would accept if you're doing a \$50 million or \$100 million deal?

Jennifer Sherman

Yes. I think that, for us, it is can this business operate within our target EBITDA margin range and is there opportunity for further EBITDA margin range expansion through the cycle. There are examples of businesses that we bought that are below the target EBITDA margin range but we believe in terms of the power of the platform and various synergies on operational improvements, that they can operate within the range and then there's opportunities to increase over time. That has been several of the acquisitions we've done.

The more recent acquisitions have operated within the EBITDA margin range and we've raised those ranges because of the synergies and operational improvements that we've executed.

Steve Barger

Got it. I think you addressed sort of a few ways that you can add new market adjacencies, adding to verticals and I think there was one other. What is the most likely outcome if you can handicap it? Or, do you have a preference for how you approach those?

Jennifer Sherman

No. Again, it is—I think we have a good mix right now in the pipeline across the three examples that I gave. Again, it really comes down to what synergies do we bring, how do we improve performance and how do we grow the business.

Steve Barger

Got it. Okay, thanks.

Jennifer Sherman

Thanks, Steve.

Operator

Our next question comes from the line of Walt Liptak with Seaport Research. Please proceed with your question.

Walter Liptak

Hi, thanks for taking the follow-up. The SSG part of the business, the orders I thought were on kind of a tough comp with last year and they grew nicely, 7%. Can you give us a little bit of color on what's going on there? Were these international orders that you're taking in? Are they domestic? Is it market share wins? Or, is it growth in the market?

Jennifer Sherman

I'll start with the teams are just doing a super job on execution of the strategic initiative. I think investment in the business in particular, where we see strong new product development and we're seeing the benefits from that. They were able to secure several—particularly in police, we've been able to secure several orders. We talked about the one large order that we secured near the end of the quarter that we'll deliver next year. Our VAMA team in Europe has done a really nice job also. Our signaling and warning team has done a nice job.

So, what we're encouraged about is just excellent execution on strategic initiatives, including, as we've talked about many times, 80/20 and the results that we continue to see as that is part of our culture there.

Walter Liptak

Okay, great. Thank you.

Jennifer Sherman

Thank you.

Operator

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

Jennifer Sherman

Thank you. In closing, I'd like to reiterate that we are confident in the long-term prospects for our businesses and our markets. We remain focused on executing against our strategic framework. We would like to express our sincere 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

This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation.