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Federal Signal Corporation

Fourth Quarter 2021 Conference Call

March 1, 2022

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PRESENTATION

Operator

Welcome to the Federal Signal Corporation Fourth Quarter Earnings Conference Call.

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 Fourth Quarter 2021 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'll 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 I turn the call over to Jennifer, 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-K later today.

Jennifer is going start today with a recap of the year, and then I will provide some more detail on our fourth quarter and full-year financial results. Jennifer will then provide her perspective on our performance and go over our outlook for 2022 before we open the line for any questions.

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

Jennifer Sherman

Thank you, Ian.

I'd like to start by giving my profound thanks to each of our employees and our business partners for their ongoing commitment. I am immensely proud of how our teams have managed through another turbulent year, finding creative solutions when faced with widespread supply chain disruption and demonstrating tremendous resilience given the prolonged nature of the pandemic, including the impact of the resurgence of cases linked to the Omicron variant.

Our strong performance is a testament to the efforts of our teams and the successful diversification of our revenue streams and end market exposures that has taken place over the last several years through our combination of organic growth initiatives and disciplined M&A.

Despite the ongoing challenges in the marketplace, our teams remained relentlessly focused on serving our customers, helping us to deliver the second highest adjusted EPS in the Company's history, report record orders, and maintain an EBITDA margin of approximately 15% towards the high end of our target range.

In addition to our strong financial performance, we also made good progress against several of our long-term objectives in 2021. We continued to invest in internal growth initiatives by making strategic investments for the future by purchasing new machinery and equipment aimed at gaining operating efficiencies and expanding capacity at several of our production facilities.

We also recently completed the acquisition of two of our largest manufacturing plants, our Elgin Sweeper facility in Illinois, as well as our facility in University Park, Illinois, which is home to our domestic SSG operations. Both of these facilities were previously leased and with the leases expiring towards the middle of next year, we are pleased to have secured the future of these operations, allowing us to better optimize the facility over the long run and leverage our 80-20 principles.

We continue to invest in new product development with a particular emphasis on electrification projects and are encouraged that these efforts will provide additional opportunities to further diversify our customer base, penetrate new end markets, or gain access to new geographic regions. We completed three acquisitions in 2021 with the additions of OSW, Ground Force, and Deist, providing us with opportunities to expand our geographic footprint and augment our specialty vehicle product offerings.

The integration of these businesses is going well, and we see meaningful opportunities for synergies and potential for additional investments to further strengthen and broaden our position in these attractive niche markets. We demonstrated our commitment to returning value to our stockholders, funding a combined $37 million of cash dividends and share repurchases.

Our 80-20 improvement initiatives remain a critical part of our culture and we continue to focus on reducing product costs and improving manufacturing efficiencies across all of our businesses. To highlight our ongoing focus on operating as a socially responsible and sustainable manner, we also published our second annual sustainability report in the fourth quarter. I am incredibly proud of progress that we've made on our environmental, social, and governance initiatives and thrilled to share our many accomplishments highlighted in this report.

I'll now turn the call back to Ian to go over the numbers.

Ian Hudson

Thank you, Jennifer. Our financial results for the fourth quarter and full year of 2021 are provided in today's earnings release. Before I talk about the fourth quarter, let me highlight some of our full year results.

Consolidated net sales for the year were approximately $1.21 billion, up $82 million or 7% compared to last year. Operating income for the year was $130.7 million compared to $131.4 million last year. Consolidated Adjusted EBITDA for the year was $180.5 million compared to $182.2 million last year. That translates to a margin of 14.9% this year, compared to 16.1% last year.

GAAP earnings for the year equated to $1.63 per share, up $0.07 per share, or 4% from last year. On an adjusted basis, we reported full year earnings of $1.75 per share, up $0.08 per share or 5% from last year.

For the rest of my comments, I will focus on comparisons of the fourth quarter of 2021 to the fourth quarter of 2020. Consolidated net sales for the quarter were $301 million, up $7 million or 2% compared to last year. Consolidated operating income in Q4 this year was $30.1 million compared to $33.8 million last year. Consolidated Adjusted EBITDA for the quarter was $40 million compared to $47 million last year. That translates to a margin of 13.3% in Q4 this year, compared to 15.9% last year.

In the current year quarter, we incurred a non-cash pre-tax pension settlement charge of $10.3 million in connection with a defined benefit pension annuitization project, and realized approximately $3 million more in discreet tax benefits than in the prior year quarter.

Including both of those items and a benefit from M&A related activity, our income from continuing operations in Q4 this year was $19.5 million compared to $26 million last year. That equates a GAAP EPS of $0.32 per share, compared to $0.42 per share last year. On an adjusted basis, EPS for Q4 this year was $0.40 per share, which compares to $0.44 per share last year. Orders in Q4 this year were $444 million, a new record for the Company and an increase of $168 million or 61% from last year.

Our orders in the current year quarter included approximately $18 million of backlog acquired in the Ground Force and Deist acquisitions. The unprecedented order intake contributed to a record backlog at the end of the year of $629 million, more than double the amount at the end of last year. In terms of our fourth quarter group results, ESG sales were $246 million, an increase of $8 million or 3% compared to last year.

ESG's Adjusted EBITDA for the quarter was $36.2 million compared to $44.2 million last year. That translates to an Adjusted EBITDA margin of 14.7% in Q4 this year, compared to 18.6% last year. During the quarter, various commodity costs continued to increase and chassis delivery dates slipped. The pricing actions we had previously implemented assumed delivery of chassis on certain promise dates.

As these deliveries were pushed out, we experienced an unfavorable price cost headwind of around $5 million during the quarter, which was about $2 million higher than we had previously anticipated. This impact was primarily felt within our dump truck businesses where the customer provides the chassis and we have less control over delivery dates.

We also saw a significant increase in coronavirus related medical expenses during the quarter, incurring approximately $2 million visit of expense associated with a handful of hospitalizations and tragically, our first COVID-related employee death. Within SSG, sales for the quarter were $56 million compared to $57 million last year. SSG's Adjusted EBITDA for the quarter was $11 million compared to $11.2 million a year ago.

It's Adjusted EBITDA in Q4 this year was 19.7% compared to 19.6% last year. Corporate operating expenses in Q4 this year were $4.1 million compared to $9.8 million last year with most of the reduction due to fair value adjustments of acquisition related liabilities.

Turning now to the consolidated income statement where despite the year-over-year sales increase, gross profit decreased by $8.5 million. Consolidated gross margin for the quarter was 22.4% compared to 25.7% last year. As a percentage of sales, our selling, engineering, general, and administrative expenses for the quarter were down 50 basis points from Q4 last year.

During the fourth quarter, we recorded a $3 million benefit from acquisition related activity compared to $1.3 million of expense last year, with the majority of the year-over-year change driven by the fair value adjustment I just referenced. Other items affecting the quarterly results include the pension settlement charge I mentioned earlier, a $300,000 increase in amortization expense, and a $400,000 reduction in other income.

In Q4 this year, we also recognized several discreet tax benefits, which resulted in a lower than expected effective tax rate for the quarter. Overall, we recognized a $300,000 tax benefit in Q4 this year compared to expense of $7.6 million last year, with the year-over-year change largely driven by lower pre-tax income levels and the incremental discreet tax benefits. Including discreet tax benefits, our effective rate for 2021 was low at approximately 15%.

For 2022, we currently expect a tax rate of approximately 25% excluding any discreet tax benefits. On an overall GAAP basis, we therefore earned $0.32 per share in Q4 this year compared with $0.42 per share in Q4 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 benefits, pension related charges, and purchase accounting expense effects. On this basis, our adjusted earnings in Q4 this year were $0.40 per share compared with $0.44 per share in Q4 last year. Looking now at cashflow, where we generated $47 million of cash from operations during the quarter, bringing the total amount of year-to-date operating cash generation to $102 million.

Our borrowings increased during the quarter with the acquisitions of Ground Force and Deist and the purchase of our Elgin manufacturing facility. We ended the quarter with $242 million of net debt and availability under our credit facility of $209 million. Our current net debt leverage ratio remains low even after factoring in these acquisitions, as well as our more recent purchase of our University Park manufacturing facility.

With our financial position remaining strong, we have significant flexibility to pursue strategic acquisitions, invest in additional organic growth initiatives, and return cash to stockholders through dividends and opportunistic share repurchases. On that note, we paid a dividend of $0.09 per share during the fourth quarter amounting to $5.5 million, and we recently announced a similar dividend for the first quarter.

We also funded $12 million of share repurchases during the quarter. That concludes my comments. I would now like to turn the call back to Jennifer.

Jennifer Sherman

Thank you, Ian. Demand for our products remains at unprecedented levels with our fourth quarter order intake setting a new Company record, contributing to an all-time high backlog at the end of the year. In fact, our orders for the year exceeded $1.5 billion for the first time in the Company's history and we're up $492 million or 47% from last year.

We have seen improvement across the board with orders from both municipal and industrial customers up around 50% year-over-year. With lead times for certain products extended as a result of this increased demand and with the need for certain customers to secure a chassis, we saw some dealers place advanced orders during the fourth quarter.

This acceleration of orders, which has continued so far this year, could cause some distortion in the comparability of our orders as we move through the year. As we had anticipated, our fourth quarter results were impacted by shortages and delays in delivery of various components we required to manufacture our products.

In particular, a limited supply of chassis associated with reduced allocations from chassis OEMs and delivery delays forced us to constantly modify our production schedules and sporadically shut down operations at certain facilities. Such disruptions impacted sales at almost all of our vehicle based businesses within our Environmental Solutions group. Shortages of hydraulics, pumps, and certain electrical components also became more prominent this quarter.

Our teams have been creative and nimble in adapting and identifying solutions to these supply chain challenges. As an example, our SSG team has brought production of a number of components in-house, including hand stuffings, soldering, and testing PC boards, that our suppliers were able to only partially complete.

With our diversified product and service offerings, we have been able to provide our customers with rental and used equipment to partially mitigate the current tightness in the supply chain, which has led to longer lead times for new equipment deliveries. Overall, our aftermarket revenues in Q4 this year were up $12 million or 19% compared to last year, growing to represent a higher share of ESGs revenues for the quarter at around 30%.

Turning to labor, toward the end of the year, we started to see an escalation of cases linked to the Omicron variant, which caused a dramatic increase in employee related absences within our manufacturing facilities. Many of our key suppliers also experienced the same. Those trends have continued into the new year.

In January, we were hit particularly hard, essentially all of our facilities recording almost 300 positive cases, which was about 8 or 9 times higher than the run rate in prior months. In fact, at one of our dump truck facilities, we had more than 40% of the workforce out at one point, either with confirmed COVID or through required quarantines.

Overall, we estimate that we lost approximately 20,000 direct labor hours across our facilities in January alone. As a result, we have not been able to operate as efficiently as we had planned. Thankfully, we have seen some recent improvement in case counts. Input costs related to purchase materials, logistics, and labor continued to rise in the quarter. Although we've seen some relief recently with decline in steel prices, aluminum has increased dramatically.

We have also experienced delays in the receipt of customer supply chassis at our dump truck businesses. At one of our dump truck facilities, for example, we are currently receiving about half of the chassis we need to satisfy our current production demands. With chassis deliveries being pushed out and with inflation at 40 year highs, we are experiencing margin pressure in our dump truck businesses during the first quarter.

As we have throughout 2021, we have responded accordingly with pricing actions. With various actions we have taken, including repricing of our backlog in a number of our businesses, we are expecting to see improvements as we progress throughout the year with more price realization expected as our backlog turns. Looking forward, we remain focused on delivering strong results while continuing to execute on our long-term strategy.

Our strong balance sheet provides opportunities for us to drive both our organic growth initiatives and pursue additional strategic acquisitions. Over the last several years, we've transformed our end market exposure and implemented a revenue diversification strategy that has enabled us to adjust as needed to market conditions.

Our aftermarket business has grown to represent about 30% of ESGs revenues and we see additional opportunities to grow that business by expanding into new geographies we believe to be underserved. We are also making progress with our electrification efforts and were recently joined by the Mayor of Los Angeles and other state and local representatives for the delivery of the first two plugin hybrid electric Broom Bear street sweepers to be placed into service.

We have also begun demonstrations of our hybrid three-wheel Pelican sweeper and solidified an agreement with a development partner for the hybrid system used in the hybrid Broom Bear sweeper. Demand for demonstrations from our dealer network is high. We are exploring other ways to further integrate electrification into our suite of products with around 20% of our overall R&D budget allocated to these efforts.

As our orders suggest, we are already seeing some of the impact from the Federal Stimulus funding that was introduced in 2021, providing much needed funding to state or local municipalities whose budgets were impacted by the pandemic. We are also continuing to monitor developments with respect to a long-term infrastructure legislation, which we believe will provide visibility for project planning and could see capital equipment demand increase in areas such as roads, bridges, broadband, clean energy, and public transportation build out.

We anticipate this would provide significant benefits for the majority of our product offerings, including sales and rentals, safe digging trucks, road marking equipment, sewer cleaners, street sweepers, dump trucks, and trailers. Within our industrial markets, we continue to be bullish about our prospects with respect to our safe digging initiative and are monitoring further developments on the regulatory front.

With a recent increase in oil prices, we expect to see an uptick in demand for our safe digging products. I recently attended two of our largest trade shows. At these shows, we showcased our road striping, sewer cleaning, and safe digging products, including the newest product in our expanding safe digging portfolio. The TRUVAC trucks vacuum excavator is a compact trailer with the power and features required at a variety of job sites to perform a wide range of tasks.

This new product, which was developed by our TRUVAC innovation team in less than a year, opens up a new end market for our valuable TRUVAC line. Reaction from our customers and dealers at the show was overwhelmingly positive.

We have positioned Federal Signal in a manner in which we will fully participate in the post pandemic recovery through our investments in capacity within our facilities, reduce lead times to where we can better respond to customer needs, investing in new product development, and gaining market share.

On the M&A pipeline front, it remains active and we continue to believe that M&A will be an important part of our growth. On the flip side, like many companies, we expect the current supply chain environment and inflationary pressure to linger in 2022.

Turning now to our outlook, we remain encouraged by conditions in our end markets, the ongoing execution against our strategic initiative, and the order trends that we have seen over the last few quarters, which have contributed to a record backlog entering 2022.

As a reminder, seasonal effects typically result in our first quarter earnings being lower than subsequent quarters. Similar to most parts of the country, we have recently seen a dramatic increase in coronavirus cases and quarantines at all of our domestic facilities. Adverse weather conditions also caused us to temporarily close operations at several facilities in January.

Combined with a highly unpredictable supply chain environment, these factors have caused significant disruption in operations so far this year, and we believe this uncertainty will continue at least during the first half of 2022. In particular, delays in receiving customer supply chassis have been more prevalent than we anticipated within our dump truck businesses.

On the other hand, we are encouraged that delivery of chassis that we procure from our suppliers for our Vactor, Elgin, and MRL businesses have to date been generally in line with our expectations. We are also continuing to navigate our way through unprecedented inflationary pressure, and although we have taken actions in response, supply chain constraints have delayed the realization of some of those actions. Because of these factors, we are not currently operating at our expected level of efficiency.

Nevertheless, and despite the softer than normal first quarter, we anticipate recovery over the remainder of the year and currently expect our earnings in the second half of the year will represent approximately 60% of our full year earnings.

For the full year, we currently expect to report net sales of between $1.35 billion and $1.45 billion, and adjusted EPS of between $1.76 and $2 per share, despite a headwind of approximately $0.20 per share resulting from the normalization of our tax rate in 2022.

With backlog as indicated, market demand remains robust for most of our products, and active M&A pipeline, ongoing investments, and new product development, capacity expansions, and our people, and with anticipated multi-year tailwinds from the infrastructure legislation passed November, our businesses are well positioned for long-term sustainable growth.

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

Operator

The first question comes from Steve Barger from Keybanc Capital Markets. Please go ahead.

Steve Barger

Hey, good morning.

Jennifer Sherman

Good morning.

Steve Barger

I'll just start on ESG operating margin. It's been in a pretty tight range around the low 13% area for about four years now, and modeling this out, it seems like 2022 margin could be similar to last year. Can you talk about how you see a path to higher margin and ESG, or is the plan more just maintaining this kind of range while growing the top line?

Ian Hudson

Yes. I think obviously, Steve, the recent acquisitions we've had have been included within the ESG segment. I think when we think about the potential to grow the margins in that segment we do, when we look at acquisitions, one of the questions we ask ourselves is whether they are operating within that target range currently, or whether they have the ability to get within that range after a period of two to three years once we can start applying our 80-20 principles.

I think that would be one area, the two acquisitions that we completed in Q4. Of those, Deist had a double digit EBITDA margin at the time of acquisition and Ground Force was within our range towards the lower end of our target range for the group. We think there is room to grow those businesses. We also think there's room to grow the aftermarket businesses.

Jennifer mentioned, we're looking to expand into some new geographies that we think are underserved. We think that margin profile would allow for some margin improvement on the ESG side.

Steve Barger

Am I correct in thinking that the guidance contemplates a similar margin range in ESG in 2022 as we saw in '21?

Ian Hudson

Yes, I think that's probably fair, Steve, because as we talked about, there is some pressure in the first quarter as we described because the dump truck businesses is the component of ESG. There will be some pressure in Q1, but as we move through the year, we're expecting that to improve as we start to realize more price.

I think overall, and we typically look at EBITDA margin, Steve, for that business. Our target ranges are EBITDA margins as opposed to the operating margin because of the amortization impact of the recent acquisitions. From an EBITDA margin standpoint, I still think we're expecting ESG would be operating in the upper half of its target range for '22.

Jennifer Sherman

Yes, and the pandemic and some of the supply chain challenges have delayed some of our expectations regarding margin improvement of the recent acquisitions. We've got plans in place. We've been able to successfully improve margin profile of previous acquisitions, and that has been delayed in part because of the pandemic and supply chain challenges.

Steve Barger

Yes. Understood, and to that point, when I think about the 40, 60 front half back half weighting, it seems like you're thinking 1Q EPS comes in well below 1Q '21. Do you expect 2Q is below as well or is that pressure primarily in 1Q manifesting in a much weaker quarter and then more normalizing in 2Q?

Jennifer Sherman

It is a much weaker quarter for Q1 and more normalizing in Q2.

Steve Barger

Got it, and I'll just ask one more and then jump back in line. Just as you think about your mix of organic growth and the likely pace of acquisitions, if we assume that you continue at the rate you have done, what is the right incremental margin on a consolidated basis going forward?

I know that's a tough question to answer because of mix and acquisition integration costs and everything else, but just your guidance this year implies a mid-teen or slightly below at the midpoint. Is that where we live, if you continue to do deals at this rate?

Jennifer Sherman

I'll go back to what Ian said is we're very focused when we evaluate acquisitions about whether they can operate within that target range. It's not just for acquisitions. It's also, as we look at new organic growth initiatives or new projects, we look again at whether they can operate within that target range through the cycle.

Given our backlogs, as we move through the supply chain challenges, I'm very confident with the capacity expansions that we've done, that we'll be able to move to the higher end of those ranges as we move through the year. Particularly for our Vactor and TRUVAC businesses.

Steve Barger

Got it. Thanks.

Operator

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

Jennifer Sherman

Good morning, Mike.

David Johnson

Good morning. This is David Johnson for Mike, actually.

Jennifer Sherman

Hi, David.

David Johnson

It's been over a year now with the new presidential administration. Can you share any information on any changes made by OSHA or other government agencies that might be supportive of the safety and security business in the near term?

Jennifer Sherman

With respect to OSHA, one of the things that we monitor very closely is on the safe digging side of things. We continue to see more states adopt safe digging as a best practice, similar to what OSHA has done. That, we believe, will be a very important tailwind for that particular business. We haven't seen any specific action that would benefit the SSG side.

Obviously, as we talked about, the Federal Stimulus package that was passed, we're starting to see the benefit of that with respect to our orders. There are certain municipalities that frankly couldn't afford our products, and with access to these funds, they've been able to afford our products.

Again, one of the things that I'm very encouraged about is the infrastructure legislation that was passed in November of last year. I know there's going to be some commentary this evening about how it's going to be dispersed and we believe that's a very important catalyst for growth for most of our businesses.

David Johnson

Got you. That's very helpful. Thank you, and also, do you see any customers switching brands or even trying to find used trucks for upfitting?

Jennifer Sherman

I think right now, given the chassis constraints, that customers are trying to find new chassis, used chassis, any chassis that they can. As I talked about on the call, one of the things we are encouraged about is although we're on allocation for our non-dump truck businesses, the chassis supply has been more predictable, which has helped us with efficiency in those businesses and we believe, based on what the chassis suppliers are saying, that we should see some improvement in the second half of this year.

David Johnson

Awesome. Thank you very much.

Operator

The next question comes from Walter Liptak from Seaport Global Securities. Please go ahead.

Jennifer Sherman

Morning, Walt.

Walter Liptak

Hi, good morning. Hey, I wanted to ask about the revenue guidance. At the low end of the 2022 sales guidance of $1.35 billion, that seems a little bit low considering the order entry and the backlog and things like that. I wonder if you could talk about what would have to go wrong for you to come in at the low end.

Jennifer Sherman

We've assumed that there are going to be improvements in supply chain in the second half of the year. Based on what we've seen so far this year, I said we are encouraged about the chassis predictability, particularly for our Vactor, Elgin and MRL businesses. If those assumptions were wrong, that we didn't see that improvement in the second half of the year, that could move us to the lower end of the range.

Walter Liptak

Okay, great.

Jennifer Sherman

The other thing I would add is if we saw some type of resurgence of the coronavirus similar to what we saw in January, which I do believe was unprecedented.

Walter Liptak

Yes. It sounds like things are getting better, though. That’s good, right?

Jennifer Sherman

Absolutely.

Walter Liptak

Okay. The order entry looked great. I wonder if you could just go into a little bit more detail. You made a comment in the prepared remarks about some dealers placing orders in advance of something. I wonder if you could just flesh that out a little bit.

Jennifer Sherman

Sure. The first comment I want to make is we've done analysis and the strong orders were really across the board. That was one of the things we were encouraged about. We saw really nice improvement in both the municipal and the industrial side of the business.

However, with longer lead times, we've seen some of our dealers’ place orders. The other important factor is chassis availability for them, and so in order to secure the chassis that they need, it is easier to secure those chassis if they've placed orders. Again, I want to emphasize that we saw those strong order trends continue in January and we're encouraged by what we're seeing.

Walter Liptak

Okay. That sounds great, and maybe a last one for me is just on aftermarket in the ESG at 30% is good. What was the growth rate of aftermarket and is that something that's sustainable?

Ian Hudson

Walt, if you look at Q4, the aftermarket revenues in the aggregate were up about $12 million, so that's a growth rate of about 19%. For the full year, it would've been up about $56 million and that's a 24% growth rate.

I think what we described in our prepared remarks with the tightness in the supply chain, having this tool in our toolbox to be able to offer red rentals or used equipment to our customers, we are certainly seeing the benefits of that strategy in '21 and we expect that to continue in '22.

We think the aftermarket business continues to be an area of focus for us. 30% of ESGs revenue, that's close to what we were aiming for when we started on this journey. I think we are certainly encouraged with the prospects and as we described, we're looking to potentially expand into some new geographies that we think are underserved.

Jennifer Sherman

Absolutely. I just want to echo, the aftermarkets team just had a fantastic 2021 is really off to a strong start and we continue to be encouraged by the growth opportunities for that business unit.

Walter Liptak

Okay, great. Thanks.

Operator

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

Chris Moore

Hey, good morning, guys. Thanks for taking a few.

Jennifer Sherman

Good morning, Chris.

Chris Moore

Good morning. Maybe just trying to get a sense for the rough mix between volume and price at the midpoint of revenue guidance and how that would change if you were able to approach the higher end? Would the higher end be more volume focused?

Ian Hudson

I think, Chris, if you look at the overall implied growth rate in our revenue outlook, it's 11% to 20%. I think there is obviously the full year contributions from the acquisitions, so that's between probably 6% and 7% of the growth is coming from the acquisitions. That implies organic growth of between 4% and 12%.

I think that the pricing is probably more in the 3% to 5% range based on the actions that we've taken. Obviously, the volume is the variable in that equation as we talked about the supply chain. I think it's more, to get to the upper end of the range, it's more of a volume driver if we get more supplies and if it eases beyond what we expect, then I think we would be likely towards the upper end of the range or the upper half of the range.

Jennifer Sherman

Yes, and as I think about it, we did a number of capacity expansions. We have the backlog. We have generally good access to labor. As we move through these issues, which I'm confident we will, we're in an excellent position for the second half of this year and as we move into '23.

Chris Moore

Got it. That makes sense. We were talking about the aftermarket, so just in terms of used equipment sales in Q4, I'm assuming that that was up meaningfully. Does that have any impact in your rental revenue in '22 given the difficult to build things and have that rental fleet where you need it to be?

Ian Hudson

Yes. Obviously, with the strength of the used equipment sales, and you're right, it was up about 50% year-over-year in Q4, Chris. It was strong used equipment sales that we saw. We had factored into our plans for '22, in our planning processes, a significant replenishment of our own fleets and in fact, growing the size of the fleet.

That's all baked into our plans that we have at the factories and we've gone out and we've made sure we've procured the chassis to fulfill that demand. We are still expecting rental income to grow year-over-year, but as I say, we had factored all of that into our plans for '22, so that's baked into the outlook.

Jennifer Sherman

To reiterate, we are still on track with respect to the investments that we're making in our rental fleet for 2022 to support that year-over-year growth.

Chris Moore

Got it. I appreciate it. I'll leave it there. Thanks, guys.

Jennifer Sherman

Thank you.

Operator

The next question comes from Greg Burns with Sidoti & Company. Please go ahead.

Jennifer Sherman

Morning, Greg

Greg Burns

Morning. Can you just talk about the complexion of the backlog, the split between municipal and industrial, and what is tied to fixed contracts and the timing of how you see the pricing realization occurring over the next year?

Ian Hudson

I think when we look at our orders, we've seen—I think Jennifer mentioned, it's been across the board, so both municipal and industrial orders in '21 were both up in excess of 50%. It's a nice balance of muni and industrial.

There are obviously some on the municipal side, it is a little more difficult to have price adjustments of the backlog. There is a little bit more pressure on the municipal side of the business. I think that's what some of the impacts that we're expecting in Q1 on the dump truck side is reflective of that municipal business that is not including the price adjustments that we've made.

Greg Burns

Okay, and in terms of the dump truck business, is there anything you can do to help your customers get supply chassis? Can you use your procurement to get them chassis? Is there any remediation that you could do for them going forward?

Jennifer Sherman

Rest assured, we’re exploring every option.

Greg Burns

Okay, and then on the electrification front, when you look at the competitive landscape, where do you think you are in terms of your electrification projects? Are there other competitors out there with demoing trucks? Do you have a sense of where you sit in terms of your market position in terms of electrification?

Jennifer Sherman

We believe with respect to the U.S. manufacturers in the markets we operate, we're in a leading market position on electrification. On the street sweeper side of things, there are some smaller European players that have electric offerings, although generally U.S. municipalities tend to buy from U.S. manufacturers.

Greg Burns

Okay, and then when we think about electrification, will that expand your total addressable market or is it going to be more of like a replacement cycle accelerator?

Jennifer Sherman

I think it's really both because given our focus on electrification and the products that we've introduced, there's certain municipalities that have objectives in terms of buying electric vehicles. We believe that we'll be in a leading position to provide those. Also, as replacement cycles occur, they will consider our product vis a vis competitors given where we are on that development journey.

Greg Burns

Okay. Thank you.

Operator

The next question comes from Marco Rodriguez from Stonegate Capital Markets. Please go ahead.

Jennifer Sherman

Good morning, Marco.

Marco Rodriguez

Good morning, everybody. Hey, thank you for taking my questions. I was wondering if maybe you could talk a little bit more about the chassis lead times. Obviously, supply chain issues are all over the place, but can you help us understand what do those lead times look like in weeks or months and if you can contrast that to what is a normal lead time and how you see—if I remember correctly, in your prepared remarks, you said you're expecting that to improve in the second half. Can you just give us a sense of that improvement?

Jennifer Sherman

Sure. It really varies business to business. With respect to our dump truck businesses, we do not procure the chassis. It can vary depending on the type of customer. With respect to our Vactor, Elgin, MRL businesses, it's a combination. In some cases, we procure the chassis. In some cases, our customers procure the chassis. We have worked very closely with our customers on a number of aggressive chassis procurement initiatives. Lead times are extended right now. All the chassis manufacturers, the vast majority are sold out for 2022, so we're into 2023.

We have our allocations as do our dealers for 2022. Where there's upside is if we can procure additional chassis. Our teams and our dealers are very focused on opportunities to procure additional chassis because what I said earlier is we're in a position where we've done a number of capacity expansions. We have relatively good access to labor, so we're ready to go because we want to reduce our only times given our unprecedented backlogs.

Marco Rodriguez

Got it. Thank you, and then in terms of the margin impressions, you guys saw quite a bit of commentary and I appreciate some of the figures. I believe I got a $5 million headwind price cost. I'm assuming most of that is in a gross margin pressure line. Can you maybe just unpack that area?

It seems like it came up a bit short versus—at least for our estimate. Where were the big numbers that you saw? If you can help rank the pressures you saw there, and I'm assuming based on guidance, that the expectations is that pressure should remain in Q1 and maybe alleviate a bit in Q2.

Ian Hudson

On the gross margin front for Q4, we had the $5 million unfavorable price cost impact in the fourth quarter. We also had a $2 million increase in coronavirus medical expenses that we described in our prepared remarks. Combined, that's about $7 million of pressure that would've really been impacting the gross margins within ESG.

When you look at that comparison, Q4, we went from about a little over 23% down to a little under 20% on the gross margin front in Q4. If you adjust for those two things, it would've been more in line, I would say, although it would've still been down slightly with just some of the general inefficiencies we had in the supply chain disruption.

I think those are the two largest variables that we mentioned in our prepared remarks that impacted gross margin in the quarter.

Marco Rodriguez

Got it, and just the manufacturing efficiency that you had with all the absences, I don't remember if you mentioned this on the call, but that has started to improve or has improved or has gone, and obviously, you're not operating a complete capacity because you don't have the chassis availability. Can you comment on that a little bit?

Jennifer Sherman

Sure, absolutely. We've seen dramatic improvement in the second half of February where we're really back to a more normal state in this coronavirus world. It started similar to the rest of the country and in our Canadian operations also, it started towards the holidays in December. It peaked pretty dramatically in January, and then as we exited January, we saw a dramatic decline.

Marco Rodriguez

Got it, and then in terms of the M&A pipeline that you had mentioned, you're obviously very focused on that. It's an important part of your overall strategy. I'm just wondering here, with all the volatility that's out there from a macro standpoint, also given the fact that you guys did three acquisitions last year, which I believe is the most acquisitions you've done in about a 12-month period for at least the last seven years, can you maybe talk a little bit about your ability to take on more acquisitions?

Jennifer Sherman

We think we're very well positioned to take on more acquisitions and we have. We're in active dialogue right now. It's a critical part of our growth story. We believe that our aftermarkets business, as we referenced earlier, there are opportunities there, opportunities really across the board, and we think we're getting the playbook down pretty well.

The other thing that's important to note is two of the three acquisitions that we did in 2021 were acquisitions that we sourced. They were exclusives to us, and we have that ongoing dialogue going on. We believe we've got a good playbook and we're committed to executing against that.

Marco Rodriguez

Got it. Thank you, guys. I appreciate the time.

Jennifer Sherman

Thank you.

Operator

This concludes the question-and-answer session. I'd like to turn the conference back over to Jennifer Sherman for any closing remarks.

Jennifer Sherman

Thank you. In closing, I would like to reiterate that we are confident in the long-term prospects for our business and our markets. Our teams are performing at a high level and remain focused on delivering high quality results.

We continue to aggressively address supply chain challenges, and we believe we are winning in the marketplace with our customers. We remain committed to investing in our businesses and our people to generate sustained long-term success for our shareholders. Our foundation is strong and we are focused on delivering profitable, long-term growth through the execution of our strategic initiative. Thank you.

Operator

This concludes today's conference call. You may disconnect your lines. Thank you for participating and have a pleasant day.