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PRESENTATION

Operator

Good day, and welcome to the ESCO Q3 Conference Call. Today's call is being recorded. With us today are Vic Richey, Chairman and CEO; Chris Tucker, Vice President and CFO. And now to present the forward-looking statements, I would like to turn the call over to Kate Lowrey, Director of Investor Relations. Please go ahead.

Kate Lowrey - *ESCO Technologies Inc. - Director of IR*

Thank you. Statements made during this call regarding timing of recovery and growth of our end markets, the amounts and timing of 2021 and beyond revenues, impacts of COVID and COVID variants and recovery expected as a result of COVID vaccines, recovery in commercial aerospace adjusted EPS, adjusted EBITDA, cash, shareholder value, the timing of Block V deliveries, success in completing additional acquisitions, success in integrating acquired businesses, the results of cost reduction efforts, the correction of production and inventory issues and other statements, which are not strictly historical, are forward-looking statements within the meaning of the safe harbor provisions of the federal securities laws.

These statements are based on current expectations and assumptions, and actual results may differ materially from those projected in the forward-looking statements due to risks and uncertainties that exist in the company's operations and business environment, including, but not limited to, the risk factors referenced in the company's press release issued today, which will be included as an exhibit to the company's Form 8-K to be filed. We undertake no duty to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

In addition, during this call, the company may discuss some non-GAAP financial measures in describing the company's operating results. A reconciliation of these measures to their most comparable GAAP measures can be found in the press release issued today and found on the company's website at www.escotechnologies.com under the link Investor Relations.

Now I'll turn the call over to Vic.

Victor L. Richey - *ESCO Technologies Inc. - Chairman, President & CEO*

Thanks, Kate, and thanks, everyone, for joining today's call. Before we jump into the details of the quarter, I'd just like to thank our employees across the company for their ongoing efforts to run the business. With the ongoing challenges from COVID, we continue to see great efforts and contributions from everyone across the company and for that, I'm very appreciative.

Since the beginning of the pandemic, our primary goal has remained the same, to provide a safe working environment and protect the health of our employees. And today, we continue to encourage our staff to get fully vaccinated for the benefit of everyone.

There were a few challenges in the third quarter, but overall, the company continues to perform well. Cash generation year-to-date has been excellent. We have teams focused on the working capital initiatives around the company and there's still room for improvements as we move forward. This can be a long-term value creation tool for ESCO.

Our previous cost reduction actions, along with our enhanced focus on operational efficiency will benefit ESCO going forward as our end markets continue moving toward a more normalized level of activity, and I'm confident that our disciplined approach to operating the business will result in continued success as we move into fiscal 2022.

While Chris will provide the financial details, I'll offer some top-level commentary to set the tone. While our year-to-date A&D sales continue to be lower than prior year due to COVID's impact on commercial aerospace, our portfolio diversity allowed us to mitigate this headwind as our year-to-date consolidated adjusted EBITDA margins are only down slightly compared to prior year-to-date margins.

This performance was driven by solid contribution from our other operating units as a result of a favorable sales mix and meaningful cost reductions across the company.

From a segment level, there are several positives to report. Within A&D, we're seeing signs of recovery in the commercial aerospace as passenger boardings continue to increase and more airlines are adding idle aircraft back into service. Sales of our commercial aerospace customers were still down in the third quarter as the recovery in this sector has been a bit slower than we anticipated. U.S. domestic travel has picked up, but is still slightly below 2019 levels.

Those of you who have been to an airport lately are probably surprised, but this is what the TSA statistics show. It's important to understand that business travel remains soft, and air travel in Europe and overall international travel are still well below 2019 levels. The good news is that we're starting to see order activity increase in the third quarter and our overall A&D segment orders increased by more than 40% compared to last year's third quarter.

Additionally, our Navy and Space businesses remain strong and well funded, and our outlook for near-term growth opportunities continue to materialize in both of these areas. Our Test business continues to be steady. We have a good order input on a our -- on a global basis, and we're actively managing material inflation and transportation issues as they arise. We expect Test's outlook to remain positive, driven by the strength of its served markets, including 5G, medical and automotive.

Our USG business continues to outperform from a profitability perspective with year-to-date adjusted EBIT margins of 19.4% compared to 15.1% last year. The renewables business at NRG has performed well in 2021, while the orders from Doble's utility customers have been a bit soft. We did see sales growth from Doble of approximately 8% in the quarter, but we have not yet seen demand return to pre-pandemic levels. We feel great about the long-term outlook for the USG business and are very excited about the announcements today regarding closing 2 acquisitions.

Our agreement to acquire Altanova had been announced back in May, and we were able to get the deal closed in July 29. This business brings exciting new product offerings to our USG business and also significantly increases our global footprint. Additionally, we announced today the purchase of Phenix Technologies. This is also an exciting business that further enhances the product offering of our USG group and provides greater access to the commercial and industrial markets.

We've had initial meetings with the teams for both of these businesses. I'm very encouraged by the quality of the people and their enthusiasm to join ESCO. We're confident these will be strong additions to ESCO and USG's portfolio that will drive future sales and earning growth.

So overall, the fundamentals of our portfolio remain strong. The second half sales outlook is a bit behind initial projections, but orders have started to increase, and we feel good about the growth outlook for 2022 and beyond. Now I'll turn it over to Chris.

Christopher L. Tucker - *ESCO Technologies Inc. - Senior VP & CFO*

Thanks, Vic. I'll start by briefly touching on a few comparative highlights. Sales in the third quarter grew by 5% with A&D up 1.8%, USG up 12% and Test growing 4.6%. This has been the first quarter in 2021, where we saw sales growth from all 3 segments. Adjusted EBIT margins were 12.7% in the quarter compared to 14.2% in the prior year quarter.

The margin decline was driven primarily by the operational inefficiencies and inventory write-offs at Westland. We had some commentary in the press release regarding Westland, and we wanted to mention that here as well.

In the quarter, we did become aware of some issues at Westland. They have experienced several challenges related to the new product development programs, which led to increased production cost and product quality issues. No bad product was sent or billed to customers, but we did have charges recorded in the quarter of $2.1 million and year-to-date charges of $4.4 million. The first and second quarter charges represent corrections to our previously reported financials and going forward, our 2021 year-to-date numbers will be updated to reflect these amounts. We have started work immediately to get the production issues fixed and to address cost issues within the business.

There are strong synergies between Westland and our Globe subsidiary, and we have already begun the work to bring these businesses together under one leadership structure. We have a strong outlook for this business and are committed to driving significant improvements as we move forward.

Adjusted EPS came in at $0.67 per share in the quarter below prior year's $0.76 per share. Adjusted pretax dollars were down 2.5% compared to prior year Q3. And we had an exceptionally low tax rate in prior year Q3, which further reduced EPS.

Segment highlights in the quarter are as follows: A&D did see a return to sales growth in the quarter. The Navy business grew by over 20%, which more than offset declines in the commercial aerospace sales of approximately 10%. While the commercial aerospace sales were down, we did see the rate of decline improve and we are seeing signs that the business is beginning to rebound. Margins for A&D were down driven by the issues at Westland.

USG saw growth of 12% in the quarter. The renewables business was very strong. The utility business did grow in Q3, but has not returned to pre-pandemic levels. Adjusted EBIT margins were 18.3% in Q3 compared to 14.8% in the prior year Q3. This strong improvement was driven by leverage on the sales growth and benefits from higher cost reduction activities.

The Test business grew 4.6% in the quarter, continued steady performance from this group. Margins were down in the quarter due to mix and timing issues. Year-to-date operating cash flow was up over 40%. We continue to see great results from our focus on driving balance sheet improvements.

The teams across the company continue to work multiple strategies for operating capital improvement and the results are very good. Some programs driving this performance include negotiating performance-based payments in our A&D and Test segments. This has had a significant impact as it oftentimes results in new orders being cash positive throughout the life of the contract.

Other efforts include adjusting safety stock levels and extending payment terms. Year-to-date, our adjusted EBITDA was nearly $91 million with a 17.8% margin compared to 18% in the 2020 year-to-date.

Over the past year, we took several cost reduction actions across the company that have allowed us to hold margins during this down sales environment. Examples here include closure and consolidation of facilities, the move of manufacturing content to our Mexico facility and ongoing make-buy programs.

Amortization of intangibles and interest expense decreased while tax expense as a percent of pretax income increased in Q3 and year-to-date, as we had several tax strategies implemented last year, which benefited the 2020 comparative rates.

Orders were a good story in Q3 as entered orders were strong. We booked $203.8 million of new business in the quarter ended with a backlog of $539 million and a book-to-bill of 112%. This represents 29% growth compared to prior year Q3. Strength in orders came from all 3 segments with A&D orders increasing 44%, USG increasing 10% and Test increasing 28%.

As we continue navigating through what we hope is the near end of COVID, our #1 focus remains the same, increasing and maximizing our liquidity to position us for future M&A growth and increased investment in new products and solutions. We have a strong balance sheet today and are excited about the recent acquisitions that Vic mentioned earlier. We still have ample capacity for further acquisitions and we obviously continue to invest in the core business to enhance our organic growth profile.

Our significant cash generation this year is a testament to this focus on liquidity. We have delivered free cash flow conversion of 118% of net earnings for the first 9 months. As mentioned above, we have clear momentum in our working capital initiatives.

I did want to talk for a minute about the Q4 guidance. In the release, we did provide Q4 guidance. This is the first quarter that has included guidance since Covid began. The guidance for Q4 is a range of $0.73 to $0.78 per share. The sales levels in Q4 are a key issue as we think about the guidance, and this range is predicated on a sales level in the range of $190 million to $200 million.

In the last 3 months, we have reduced the Q4 sales outlook for the commercial aerospace businesses and also for the utility businesses. The commercial aerospace backlogs are beginning to build, but we see those more as drivers for 2022 as opposed to Q4.

For the utility space, we are seeing some growth compared to prior year, but not to the levels we had previously anticipated. The long-term outlook for both of these markets continues to be positive, and we feel good about our positioning as we look towards 2022.

We also want to be clear that this outlook excludes any impact from the acquisitions that were announced today. We will have sales and earnings impacts from those transactions, but they are not yet quantified and are therefore not included in the guidance that is provided. With that, I'll turn it back over to Vic.

Victor L. Richey - *ESCO Technologies Inc. - Chairman, President & CEO*

Thanks, Chris. Since I touched on quite a few of my thoughts earlier in my commentary, I'll just offer a few more comments before we move into Q&A. As Chris mentioned, we are a little softer than planned here in the back half of the year for the commercial aerospace and Doble's utility market. This doesn't change our long-term commitment to these markets. We feel great about our end market exposure, and our diverse portfolio allows us to manage through periods like this.

Outside these markets, we see a lot of growth opportunities in A&D from the military aerospace, Navy and space end markets. Investments in the renewable energy market continued to drive very strong performance for our NRG business, and Test business sees a lot of opportunities from the telecom, automotive and medical markets.

We just finished up a Board meeting in Boston last week. And during those meetings, we took the time to visit the Doble and Globe operations. We had a great set of meetings and really exciting interactions with the teams at the operating units.

At Doble, we did a full update of the USG segment. The team has made great progress updating the product line across the business from renewable-focused products at NRG to the new F8 launch at Doble. It's great to see the innovation happen inside that business as our customers start spending again and we'll be ready to support it.

This also provided a chance to update our Board on Phenix and Altanova acquisitions, so you could firsthand see the excitement around these transactions. After visiting the Doble headquarters, we took the Board to visit the Globe facility. This was another great visit. The team at Globe has done an exceptional job. They're driving tremendous growth with the Navy surface hull treatment product line. The team has worked very hard to master a difficult manufacturing process. They're really rolling and it's fun to see a winning team in action.

We had full couple of days in Boston accomplishing all of this, but it was time well spent. I'd like to thank our Board for their ongoing support and guidance. So with that, I think we're ready for some Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

First question will be coming from the line of Cameron Lochridge with Stephens.

Cameron James Lochridge - *Stephens Inc., Research Division - Research Associate*

So I was hoping we could start on the M&A front. Great to see the 2 deals get closed, Altanova And Phenix this quarter. We're just wondering if you could update us on -- you called out the $700 million of liquidity in the press release. Maybe just what you're seeing -- what you're looking at in terms of end market exposure, geographies, things like that, valuations? Where those might stand? Any update on the pipeline would be helpful.

Victor L. Richey - *ESCO Technologies Inc. - Chairman, President & CEO*

Sure. So it's -- I'm sure you're hearing from a lot of other folks. The M&A market is pretty active right now. So we were able to get these 2 done. There's a number of other things that we're looking at. I would say, the multiples I think have settled down a little bit. They're still probably a little higher than I would have anticipated in this environment, but we are seeing good opportunities there.

I think we'll continue to focus on our utility segment and our A&D segment as far as geographical. The great thing about particularly Altanova, and to a lesser extent, Phenix, those guys as well. And both of those have really good international content. And so that really is an area we've been working to improve for a number of years. So if you look at kind of the breakout, Doble's current sales, probably 85% in the U.S. and 15% outside of the U.S.

And you look at Altanova, they're exactly the opposite. So they have some sales in the U.S. but 85% of their sales are in Europe and in Asia. And so that's really going to give us an opportunity to have a much bigger footprint outside of the U.S. and we'll be able to sell some of their products here. We'll sell some of Doble products there. And so this is really a great acquisition for us.

So Phenix is a little more 50-50, but the thing they bring is some international content, but really some new products, a lot of theirs are more high-voltage products and more applicable, in some cases, the commercial industrial markets versus in addition to the utility markets.

So those 2 -- those are the kind of things we'll continue to look for both on the utility side and on A&D. If you remember, I guess it was last quarter, maybe the quarter before, we had a small drop in acquisition in one of our A&D business, and we'll continue to look for those kind of opportunities as well.

Cameron James Lochridge - *Stephens Inc., Research Division - Research Associate*

That's great. We'll look forward to more announcements to come. I guess as a follow-up, switching to USG. I guess I was a little surprised to see the demand was still weak there. I realize with the Delta variant emerging that could -- it's probably adding a little bit of uncertainty. But maybe you could just talk to what you're hearing from customers? Maybe what's holding back that demand? Any content on that, that'd be helpful.

Victor L. Richey - *ESCO Technologies Inc. - Chairman, President & CEO*

Sure. Sure. That's -- it's hard to predict. I'd say one of the biggest issues that we're seeing is -- well, a couple of things. I mean the utility is -- still probably 90% of people are working from home. And so the people that we will be dealing with in any case. And so it's just much more difficult to do business when people aren't out there working to do the types of things that we're doing. So that's been a little bit of a surprise.

The other thing is they're more worried about delivering electricity right now than some of the other things. So a lot of the focus we see is on making sure that they're able to deliver electricity and pay attention to those type of things. They've taken a little bit of the focus off the testing of the infrastructure. We think that's -- a point in time that's going to happen, as we've talked about before, it's required that they do this type of testing. It's also a good business to do this type of testing.

So I think it's just a little bit everybody's kind of pull their horns in a little bit. It's important to remember, though, I mean it's not like we've stopped doing business there. I mean our sales are down about 10%, I think. And so we've seen some impact, we think it's going to pick up. We thought it was -- honestly, thought it was going to pick up before now. But we think as we go into '22, coming off this lower base, we'll see some pretty good upside there.

Operator

Our next question will come from the line of John Franzreb with Sidoti.

John Edward Franzreb - *Sidoti & Company, LLC - Senior Equity Analyst*

Just to stick with USG. The backlog, though, was really up nicely in the quarter. Is it a timing issue that's going on there? Is it going to be recognized more in the end of this calendar year? Or is it being pushed back into next year? Because just looking historically, it's actually a reasonably good backlog number for the business.

Christopher L. Tucker - *ESCO Technologies Inc. - Senior VP & CFO*

Yes, John, it's a good catch. Some of the -- a decent chunk of their orders that happened in the quarter were kind of some of their service contracts and their annual lease type activity. So that boosted the order number and the backlog number quite a bit.

But you'll see the revenue for that kind of stretch out over a year. So those aren't kind of book and ship type product type orders that we see in the business a lot. So that's kind of the factor there that increased the backlog a little bit relative to kind of us talking about the weaker sales.

Victor L. Richey - *ESCO Technologies Inc. - Chairman, President & CEO*

Yes, I'll just add a little bit to that. If you look at Doble's business, they're got the instrument sales, which is where we're seeing some softness. But if you look at services, that's been strong, our oil labs have been strong. The leases, as Chris said, have been strong. So it's really just 1 area where it's equipment buys. And so fortunately, I think when it picks back up, we made a great spot because as I mentioned in my commentary, they spend a good bit of time and effort refreshing a lot of their products. And so we think when we come out of this, that we're going to be at the head of the line. And the reality is, I probably should have say this earlier, but we've not lost any businesses, it's just they haven't been buying the same levels they had historically.

John Edward Franzreb - *Sidoti & Company, LLC - Senior Equity Analyst*

Okay. Fair enough. And I guess, similarly, on the Test side of the business, when I looked at the revenues, on a sequential basis, $48 million in June and, call it [$48] million in March. I was actually a little surprised that there was not an increased operating margin on that kind of revenue growth. Is this something holding back the op margin contribution there in Test?

Victor L. Richey - *ESCO Technologies Inc. - Chairman, President & CEO*

No. And I think we've talked about historically, maybe before you started following us, but the thing we have to look at with the Test business or I ask people to look at, is kind of look at it on an annual basis because there's so much variability from quarter-to-quarter that you can be led to believe that something is going on and maybe there's not. Because it's very much a project-driven business, and so the profitability from one quarter may be significantly different than it is from another quarter.

That business has held up really nice this year. I mean we're confident that on an annual basis, they're going to do exactly what we expected them to, if not a little bit better. So it's it really is a lot of variability depending on mix and what projects are going through the backlog or through the sales channel in any given quarter.

John Edward Franzreb - *Sidoti & Company, LLC - Senior Equity Analyst*

Okay. Fair enough. And I guess on the aerospace side of the business. Any thoughts about what your customers' inventory looks like? And [idea] (added by company after the call) how long it will take them to work through that inventory to get to equilibrium?

Victor L. Richey - *ESCO Technologies Inc. - Chairman, President & CEO*

I can probably answer the first half of the question better I can the second half, honestly. I think the inventory levels are coming down, certainly. I think everybody has kind of taken the opportunity to work their inventory down until they got more confidence in their build rates. I think that can only last for so long. And I think there's some -- if you read what's going on in the industry in a broader base, I think there's some concern by some of the larger OEMs about the supply base being able to support the ramp when it does happen.

That should not be a concern for us. I mean, we've obviously, with our financial capacity, we're in a position where we can ramp up quickly. We can support the customers. So I don't think that's going to be an issue. But the exact timing of that is one reason we're talking about the fourth quarter like we're talking about it because as we looked at it going in the last time we talked, I mean we thought that we're going to see a little bit more pickup in the fourth quarter, third and fourth quarter than we did.

So it's still a little hard to predict now. We've got a first look at '22, actually looks pretty good. But we're going to get an update on that in September. And so we'll be in a position to talk to you about that and talk about the assumptions we have in our plan at that time.

So I think as we get a little more time on this, we'll get better insight into what their actual build rates are going to be. They provide those over -- they seem to be a little squishy right now, but hopefully it's going to firm up here in the next 60 days or so.

John Edward Franzreb - *Sidoti & Company, LLC - Senior Equity Analyst*

Okay. And I guess just one last question if I may, on Westland and the production issues, can you just -- I'm sorry, give me some better color what's going on there? And is it behind you or not? I wasn't quite sure based on the prepared remarks.

Victor L. Richey - *ESCO Technologies Inc. - Chairman, President & CEO*

I'm sorry, I didn't hear the very last part of your question.

John Edward Franzreb - *Sidoti & Company, LLC - Senior Equity Analyst*

The last part, are the issues behind you? Are they done yet? Or are they ongoing?

Victor L. Richey - *ESCO Technologies Inc. - Chairman, President & CEO*

We've got our arms around those. I don't think there's going to be any additional issues. I think we've got -- been through this in a big level of detail. But I would say a number of things happened. I mean we had some new product development that kind of -- obviously got out of control, but kind of got out of control with a couple of products that we were ramping up on -- new product develop is always an area where you can have some concerns.

And so we had some cost growth there. We had some inventory that got built up that got ahead of us as well. Part of the issue was it's a pretty new business for us. It's a relatively small business. And in a fairly remote location. So we probably didn't have as much focus on that as honestly, we should have. And we had significant turnover in the financial group.

And so typically, that would have been caught by the group, and we had like a complete turnover in a fairly small finance group. The good news is, as we mentioned before, we didn't send any bad product out, we didn't charge the customer for anything that we shouldn't have. We've got it under control now. And so this is still a good business.

Look, I mean, it's a good business. The end customer is good. It's all Navy business, submarines and surface ships. So the end market is solid. We had a -- we had some issues. We got those fixed, and I think we'll be fine going forward.

Operator

(Operator Instructions)

Next question will be coming from the line of Jon Tanwanteng with CJS Securities.

Jonathan E. Tanwanteng - *CJS Securities, Inc. - MD*

I just wanted to approach the USG and Doble question from a different perspective. I mean, I think we're all pretty sure that, that business will come back. But I guess the question is, does it come back by the fall when the utilities usually do their maintenance? Or is there more going to be a spring of next year type recovery when they're going to be able to do it on the next cycle instead?

Victor L. Richey - *ESCO Technologies Inc. - Chairman, President & CEO*

Well, I think if you look at what happened last year and you hesitate to say this, but if you remember, we had a pretty solid first quarter last year in Doble probably, it was certainly our best quarter. And so a lot of that was kind of been up -- pent-up demand and utilities had funds that they wanted to deploy. And so we're in a position certainly to provide that for them as well.

But John, to be honest, it's really hard to predict right now. But we certainly think that given the low base we're coming off of in this quarter, we should start seeing some pickup, if not in the fourth quarter, certainly first part of next year.

Jonathan E. Tanwanteng - *CJS Securities, Inc. - MD*

Okay. Great. And then just with regards to the 2 acquisitions. I was wondering if you could give us a sense of the growth potential across them. When you consider cross-selling and synergies and also these synergies that you might be able to get off from them. I understand that Altanova done in Europe, so maybe not as much, but certainly from Phenix, which is local.

Victor L. Richey - *ESCO Technologies Inc. - Chairman, President & CEO*

Sure. So we have pretty clear synergy plans in place, and I mean, we reviewed those before we made the acquisition. Reviewed them as recently as last week. And I think they're real. And I'd say that the synergy's really probably more prevalent with Altanova because of the cross-selling opportunities that we have.

We really think we're going to be able to -- they already got some decent growth projected. Now we didn't exactly believe everything they said in their [SIM], but we do think there's some pretty good growth there. And I think getting the Doble name in there and the cross-selling that we'll be able to do with our reps and across the world.

And we've done this before, it will be significant. We did that with -- when we acquired Vanguard and Morgan Schaffer and others. And so they've done a good job historically of making sure that we get the best reps that are able to access those markets in the most effective way. And I think that same thing will happen here. In fact, I think, as I mentioned earlier, just because of their big footprint outside the U.S., I think this will be even more important to us.

Jonathan E. Tanwanteng - *CJS Securities, Inc. - MD*

Okay. Great. And then just on inflation, I guess, logistics, I think you said you wouldn't be having much trouble supplying to your customers, but I'm wondering if there's any cost that you may need to pass through and kind of if you are seeing some, how are you dealing with it? Are they being passed through quickly? Or does it take some time to do that?

Christopher L. Tucker - *ESCO Technologies Inc. - Senior VP & CFO*

Yes. I think we're actually doing it in real time. So in all 3 of the segments, we're actively working price programs. And we've got price kind of happening in real time almost. And I would also say that for some of the project type businesses, the way they think of it is they kind of roll these cost increases into their cost database. So as they're doing quotations and things like that, that kind of got the latest look at what something is going to cost them. So they're able to kind of price those projects and those programs, factoring in whatever increases we're seeing.

So generally, I think we feel like we're in pretty good shape there. And certainly, inflation is in the headlines, and we're all seeing it in dealing with it. But we've been pretty proactive communicating around price from here out to the subsidiaries. And quite frankly, that will be a key thing we focus with everybody on next month when we go through our financial review processes, and we set the '22 numbers. We got to make sure that we continue to drive those price programs. But where we are today, we feel good about that.

Jonathan E. Tanwanteng - *CJS Securities, Inc. - MD*

Got it. And just last one for me. On the cash flow, you did a pretty good job converting into cash from earnings. I'm just wondering, is there a reset or absolute at some point that brings it back down? Or is this more of a onetime permanent gain in cash?

Christopher L. Tucker - *ESCO Technologies Inc. - Senior VP & CFO*

Yes. I mean, listen, I think in my mind, I think that the balance sheet is a lever that we can kind of continue to work. I think we've got room to run with the working capital initiatives. I mean, I'm not sure we'll stay at 120% or 130% forever, but certainly, we can drive a nice -- we want to be in that 100% plus range as we move forward, and we want to drive our turnovers higher and our [ROTCEs] higher. I mean that's kind of the framework that I'll work with everybody on as we try to drive this over the long term. So I'm really excited about the work that we've done already, but I think we've got -- I still feel like we're kind of in the early innings there. We've got more to do.

Operator

And we have a follow-up question comes from the line of John Franzreb with Sidoti.

John Edward Franzreb - *Sidoti & Company, LLC - Senior Equity Analyst*

Yes. I guess just to follow up on some of John's questions. What was your projected debt level be at the end of the fourth quarter?

Christopher L. Tucker - *ESCO Technologies Inc. - Senior VP & CFO*

We're looking at a leverage ratio still below 1.5x from kind of the 0.43x that we're at today or whatever. So...

John Edward Franzreb - *Sidoti & Company, LLC - Senior Equity Analyst*

I was just curious how much drawdown of cash versus debt you were thinking about for the acquisition. That's kind of what is going with that?

Christopher L. Tucker - *ESCO Technologies Inc. - Senior VP & CFO*

Well, a lot of the cash -- we have a fair chunk of the cash on the balance sheet today that's international and not really easy to deploy towards the deal. So we work that separately to kind of get that cash back, but it's not available today as we close on those deals. So you'll see most of that going on the debt side.

John Edward Franzreb - *Sidoti & Company, LLC - Senior Equity Analyst*

And I guess, again, following on John again. I was wondering how much of unabsorbed cost or inflationary costs, you're forced to take in the third quarter, if you could call that out? Or was the pricing increases well matched that it was immaterial?

Victor L. Richey - *ESCO Technologies Inc. - Chairman, President & CEO*

I would say immaterial. I mean we had a little bit of inflation called out by a few of the subs, but not enough to really move the needle. So overall, that was kind of a wash.

Operator

(Operator Instructions)

Victor L. Richey - *ESCO Technologies Inc. - Chairman, President & CEO*

Okay. Well, listen, I think we're in the call now. Thanks, everybody, for dialing in. I look forward to talking to you in the next call. Thank you.

Christopher L. Tucker - *ESCO Technologies Inc. - Senior VP & CFO*

Thanks, everyone.

Operator

And this concludes today's conference call. Thank you, everyone, for your participation. You may now disconnect.
