THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

WAIR - Q3 2017 Wesco Aircraft Holdings Inc Earnings Call

EVENT DATE/TIME: AUGUST 08, 2017 / 9:00PM GMT

CORPORATE PARTICIPANTS

Alex Murray *Wesco Aircraft Holdings, Inc. - President and Chief Operations Officer*

Chris King *Wesco Aircraft Holdings, Inc. - CAO, VP of Finance and Global Controller*

Jeff Misakian *Wesco Aircraft Holdings, Inc. - VP of IR*

Rick Weller *Wesco Aircraft Holdings, Inc. - CFO and EVP*

Todd Renehan *Wesco Aircraft Holdings, Inc. - CEO and Director*

CONFERENCE CALL PARTICIPANTS

Gautam J. Khanna *Cowen and Company, LLC, Research Division - MD and Senior Analyst*

Jeffrey Bronchick *Cove Street Capital, LLC - Principal and Portfolio Manager*

Jonathan Phaff Raviv *Citigroup Inc, Research Division - VP*

Michael Frank Ciarmoli *SunTrust Robinson Humphrey, Inc., Research Division - Research Analyst*

Ronald Jay Epstein *BofA Merrill Lynch, Research Division - Industry Analyst*

PRESENTATION

Operator

Welcome to the Wesco Aircraft Holdings Third Quarter Fiscal Year 2017 Earnings Conference Call. My name is Adrian, and I'll be your operator for today's call. (Operator Instructions) Please note this conference call is being recorded.

I'll now turn the call over to Jeff Misakian. Jeff Misakian, you may begin.

Jeff Misakian - *Wesco Aircraft Holdings, Inc. - VP of IR*

Thank you, Adrian. Good afternoon, everyone, and thank you for participating in Wesco Aircraft's Fiscal 2017 Third Quarter Earnings Call and Webcast.

We included slides with today's presentation to help illustrate some of the points discussed during the call. These materials can be accessed by visiting our website at www.wescoair.com and clicking on Investor Relations.

We are joined today by Todd Renehan, Chief Executive Officer; and Rick Weller, Executive Vice President and Chief Financial Officer. Alex Murray, President and Chief Operating Officer; and Chris King, Vice President and Global Controller, are also here and available to answer questions in the Q&A session.

Please turn to Slide 2. As a reminder, today's conference call includes forward-looking statements within the meaning of federal securities regulations. Although the company believes that such forward-looking statements are reasonable, we cannot assure you that any forward-looking statements will prove to be correct.

Forward-looking statements are not guarantees of future performance and involve known and unknown risks, uncertainties and other factors, which may cause actual results to differ materially from those anticipated at the time the forward-looking statements are made.

Additional information relating to factors that may cause actual results to differ from our forward-looking statements can be found in the company's filings with the Securities and Exchange Commission, including the company's annual report on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K. Wesco Aircraft undertakes no obligation to update or revise forward-looking statements except as required by law.

Now I'll turn the call over to Todd Renehan. Todd?

Todd Renehan - *Wesco Aircraft Holdings, Inc. - CEO and Director*

Thank you, Jeff. Please turn to Slide 3. We know that fiscal 2017 third quarter results are poor and well below our capabilities. Rick will explain the results in detail in a few minutes. The vast majority of the issues that led to our recent poor results have been self-inflicted. So first, I'm going to talk about what we've been doing to improve our performance.

Over the past quarter, we've undertaken a number of initiatives to better understand our execution issues and formulate a plan to address them. We're focused primarily on people, customers and financials. I'm a firm believer that a fully engaged workforce will deliver great customer service, which will lead to better financial performance. Unfortunately, we've fallen down in all three of these areas. So here's what we've been up to.

We've spent a lot of time with employees, making sure they're engaged. We've also stepped up the level of communications and transparency throughout the entire company. I personally visited employees all over the United States and Europe to solicit their input, discuss our challenges and issue a call to action. I emphasized the need for greater teamwork and a relentless customer focus, along with a much greater sense of urgency and intensity.

At the same time, we significantly increased our interaction with customers and suppliers. I've met with many of our top strategic customers and suppliers, rebuilding partnerships and restoring relationships. We received positive comments about our focus on service and the value that Wesco brings to the table. We also heard candid feedback about where we need to improve and future opportunities available to us when we do.

These meetings confirmed our understanding about where we went wrong as an organization and the actions that we need to take. We've started to address these issues urgently, and we're already seeing some improvement in on-time delivery and in warehouse productivity as well as employee engagement. This is a good start, but we have a lot more work to do.

The first major change we completed was to redesign the organization around 3 regions: the Americas, EMEA and Asia Pacific. We appointed dedicated leaders and aligned functional roles within those regions. The new structure enables us to be closer to our customers by removing management layers and breaking down previous functional silos. It improves teamwork, fosters accountability and speeds up decision-making.

We also dug into our financials to improve our daily tracking of revenue, margin and cash flow drivers, and we've put in place improved internal metrics with leading indicators that will allow us to take corrective actions sooner.

We started to reexamine our inventory to establish the right balance between ad hoc demand and long-term contract needs to make sure we can adequately support all products. We're also exploring better ways to link inventory procurement with our sales forecast as this is an area where we clearly have struggled to improve. And we identified breakdowns in buying practices where we were buying too short and not taking advantage of price breaks.

Through this initial work, we identified a lot of the issues were self-inflicted performance issues that need fixing. This led us to develop a longer-term improvement plan with goals, initiatives and metrics to measure our progress. The plan is focused on four key areas. Please turn to Slide 4.

The first focus area is to address what's gone wrong with revenue growth and margin. The biggest issue is ad hoc sales performance, which has been declining trend for several years and in part due to poor service and execution issues and in part because of specific volume declines at some of our largest commercial customers.

In addition, we've not captured the growth opportunities that we believe exist within our largest strategic customer accounts at a fast enough pace, partly due to our subpar performance. We also need to do a better job proactively pursuing sales opportunities with customers who have long-term pricing agreements but no volume commitment.

To fix these issues, we put the following initiatives in place: We're improving ad hoc execution through more accurate and faster turnaround of quotes. We've developed an ad hoc pricing strategy to drive margins while still being aggressive where we want to be. This means adjusting prices to market levels based on volumes, availability and the competitive situation. We've added resources to the strategic account teams to improve penetration with our top customers and provide better service. And we're more aggressively engaging customers with long-term pricing agreements to increase the orders they place with us.

The second focus area is procurement. The issues here are that inventory has been rising significantly over the past two years while revenue has been declining. Investing to support growth and service is important. However, our inventory forecasting clearly has been off. In addition, we're not appropriately managing inventory when changes occurred, such as build rate declines. And in some cases, we bought parts anticipating revenue increases that have yet to materialize.

The shortfall in our forecasting pressured cash flow, which, in turn, pressured inventory purchase decisions and led to shorter buys at higher costs and then lower margins. In addition, the supplier LTA benefits we've worked hard to obtain were being offset by gap buys and proprietary product price increases.

We're addressing these issues through the following: First, more active inventory management, including initiatives to sell slow-moving inventory and to improve demand forecasting, aggregating demand to buy longer and optimize large quantity purchases to take advantage of price breaks. That means accelerating remaining supplier LTA agreements and instilling greater discipline and training in our buying process.

The third focus area is improving customer service and on-time delivery. There are too many part shortages for some customers' increasing production needs. We have insufficient product on the shelf for ad hoc, leading to open-market purchases that caused late deliveries and hurt margins. And warehouse operations are not efficient enough with gaps and bottlenecks in receipts and delivery flow and increased delivery expenses. To address these issues, we've added people and expanded shifts to improve throughput and on-time delivery.

We're continuing to invest in the right inventory to support new business, contract requirements for certain customers and in-stock needs for ad hoc sales. We're improving warehouse processes and KPI tracking for quicker response. And we've engaged an operational consultant to assist us with these process improvements in our warehouse operations and procurement function.

The fourth and final focus area is improving efficiency and reducing costs. What went wrong is the operating leverage is going the wrong way: costs are up while the revenue was down. This is partly because we unfortunately had to add back operational resources to fix service issues, created from past cost-cutting actions that were too deep and in the wrong places. We've also added costs to support new JIT contracts that require resources on the ground 9 to 12 months before they reach full revenue run rate. Conversely, the vast majority of our revenue declines have come from less labor-intensive ad hoc or LTA pricing agreements.

Nevertheless, parts of our organization remain inefficient and must be addressed, and we also have inconsistent performance management practices and accountability through the organization. To fix these issues, we're looking at areas to remove costs that are inconsistent with our new organizational structure without impacting the customer. This is not the kind of broad-based approach that we took a few years ago, which, as I've said, cut in the wrong places and hurt delivery performance. We're taking a more laser-focused approach to addressing our cost structure as far away from the customer as possible while we improve our processes to achieve a more acceptable level of profitability. As part of this process, we're identifying opportunities to use technology better, looking for process changes that brought improved customer service and reduced costs while driving a more performance-based culture.

We're working hard to complete our planned initiatives as quickly as possible. As I said earlier, we're seeing early signs of improvement already. But unfortunately, it's not in the numbers we're reporting today. And we know we have a lot more work to do.

I'll ask Rick to walk you through the results of the third quarter now. Rick?

Rick Weller - *Wesco Aircraft Holdings, Inc. - CFO and EVP*

Thanks, Todd. Please turn to Slide 5. Net sales in fiscal 2017 third quarter of $363.9 million decreased 3% compared to the same period last year. As you may recall, we established a new U.K. legal entity on April 1, combining legacy hardware and chemical entities with the functional currency being the U.S. dollar. As a result, the negative translational currency exchange impact in the third quarter was less than $1 million.

The decrease in net sales was due to a $10 million decline in ad hoc sales in the third quarter that principally resulted from the execution issues that Todd discussed earlier and customer production schedule changes while contract sales were stable.

Within long-term contracts, revenue realized under new business was approximately $20 million higher than the same period last year, but this was offset by volume declines at key commercial customers and lost business.

As we have mentioned previously, the commercial aerospace industry has been flat, but some of our key customers have had a more difficult year. For example, some regional and business jet OEMs have reduced production on certain platforms ahead of new model production ramp-ups, while Tier 1 customers have business or been impacted by declines in certain large commercial aircraft production. As their production rates adjust and business declines, Wesco's revenue does as well. Please turn to Slide 6.

Gross margin declined 170 basis points year-over-year in the fiscal 2017 third quarter, primarily due to lower ad hoc margin. SG&A as a percent of sales increased 240 basis points year-over-year in the third quarter, reflecting higher expenses and a lower level of sales. SG&A expenses were $7 million higher year-over-year in the quarter, primarily due to higher people costs of $6 million as well as facility and system cost increases of $2 million. SG&A included an investment of approximately $3 million to support new business, plus additional operational and resources to support improving customer service, primarily in on-site support and warehouse operations.

Following our recent leadership change and poor financial performance, we reassessed our outlook for the company's North American hardware and chemical businesses. This reassessment was based on declines in revenue, profit and cash flow over the past year and how the business could be expected to perform as a result of these trends. It is not indicative of what we believe is the company's potential performance based on the actions we intend to take and that were described by Todd. The reassessment, coupled with a significant decline in our share price, led us to test goodwill impairment earlier than our planned annual test for fiscal 2017, which was scheduled for the fourth quarter.

Consistent with our reduced sales and earnings outlook, the test indicated that estimated fair value of the North America hardware and chemical businesses was less than the carrying value, which required further analysis. As a result of this analysis, a noncash impairment charge of $311.1 million was recorded in the fiscal 2017 third quarter to reduce the carrying value of goodwill to its implied fair value.

The impairment charge led to an operating loss of $287.2 million in the fiscal 2017 third quarter. Excluding this charge, adjusted income from operations was 28 -- $23.9 million or 6.6% of net sales. The adjusted operating margin represented a 410 basis point drop compared to the third quarter of last year, primarily due to the gross margin decline and an increase in SG&A as a percentage of sales that I mentioned earlier.

Other income was $2.4 million lower year-over-year in the fiscal 2017 third quarter, primarily because of transactional currency gains in last year's third quarter.

In the fiscal 2017 third quarter, we also recorded a $10.6 million valuation allowance on a deferred tax asset for excess foreign tax credits. We generate foreign tax credits when we're taxed in both the U.S. and foreign jurisdictions on the same income. Foreign tax credits can be used to offset U.S. taxes on foreign-source income. Wesco's foreign tax credits have been building since 2012 as the qualified foreign taxes paid each year that gave rise to the credits exceeded the amount that can be utilized against foreign-source income. Excess foreign tax credits expire 10 years from the time they are generated.

While we have considered various strategies to utilize these excess tax credits before they expire, we determined in the third quarter that the future tax benefit of these credits was no longer more likely than not to be realized.

Net loss was $2.32 per diluted share in the fiscal 2017 third quarter compared to net income of $0.24 per diluted share in the same period last year. Adjusted net income was $0.10 per diluted share compared to $0.29 in the same period last year.

Adjusted EBITDA was $33.0 million or 9.1% of net sales in the fiscal 2017 third quarter. This compares with $50.9 million or 13.6% in the same quarter last year. Please turn to Slide 7.

Sales in North America were down 2.6% in the third quarter compared to the same period last year, primarily due to lower ad hoc sales. Contract sales were higher in North America, primarily due to new business revenues. This was partially offset by volume declines at existing customers and lost business.

North America's gross margin was down 110 basis points year-over-year in the third quarter, primarily due to lower ad hoc margins. SG&A as a percent of sales was up 260 basis points, primarily due to higher people-related and system costs to support new business.

The goodwill impairment discussed earlier led to an operating loss in North America of $293.5 million. Excluding the impairment charge, North America's income from operations was $17.6 million or 6% of net sales. This represented a decline in adjusted operating margin of 370 basis points, which is due to lower gross margin and higher SG&A as a percentage of sales.

Turn to Slide 8. Sales in the Rest of the World segment declined 4.6% in the third quarter, primarily due to lower volumes at existing customers and lost business, partially offset by new business revenue.

Gross margin in the Rest of World was down 410 basis points year-over-year, primarily due to the lower ad hoc margins, favorable inventory adjustments in the prior year and increased freight and expedite charges.

SG&A as a percent of sales was up 160 basis points year-over-year in the Rest of the World segment. Lower gross margin was the primary driver of the 570 basis point decline in operating margin in the Rest of the World in the quarter.

Please turn to Slide 9. Inventories increased $29 million in the third quarter of fiscal 2017. The increase reflects investment to support new business and existing contract needs. We will continue to invest in inventory during the fourth quarter to support our customers.

Total debt was $861 million at June 30. We borrowed $10 million on the revolver and repaid $5 million of term loans in the third quarter. We entered the fiscal 2017 third quarter with a leverage ratio of approximately 4.3x consolidated EBITDA compared to a covenant requirement of 4.50. Consolidated EBITDA, as defined in the credit agreement, is higher than adjusted EBITDA in our quarterly earnings reports because we're allowed to add back certain items.

With reduced expectations for free cash flow this year, coupled with lower trailing 12-month consolidated EBITDA, our leverage ratio at the end of the fourth quarter is being closely monitored. We are currently looking at financing options to address this going forward if and when they are necessary.

Please turn to Slide 10. Net cash provided by operating activities was $1 million in the fiscal 2017 third quarter compared with $52 million in the same period last year. The change in the operating cash flow primarily reflects the investment in inventory to support new business and lower profits. Free cash flow usage was $2 million versus free cash flow provided of $48 million in the third quarter of last year.

Now I'll turn the call back over to Todd for closing remarks. Todd?

Todd Renehan - *Wesco Aircraft Holdings, Inc. - CEO and Director*

Thanks, Rick. We told you last quarter that our approach on these earnings calls was to be as transparent as possible, and we've provided a candid review of our results and the self-inflicted performance issues over the past two years. We've also shared with you an overview of what we're doing to drive improvement. We've made progress, but we still have a lot more work to do. This is by no means a quick fix. Our plans are going to take time to demonstrate meaningful improvement. It's too early to give you a time frame on when to expect improved results. We're looking to fiscal 2018 as the first step in this direction, but we've just started the planning process. We expect to give you an update on our progress in our fourth quarter earnings call.

We're fully committed to Wesco's future and doing what's right for the business and our shareholders over the long term. I have a tremendous amount of confidence in our company and in our talented group of employees who continue to work hard to improve our performance.

And with that, I'll turn the call back over to Jeff to direct the Q&A.

Jeff Misakian - *Wesco Aircraft Holdings, Inc. - VP of IR*

Thank you, Todd. With that, we'll open up the Q&A period. Adrian, may we have the first question, please?

QUESTIONS AND ANSWERS

Operator

Your first question comes from Jason Gursky from Citi.

Jonathan Phaff Raviv - *Citigroup Inc, Research Division - VP*

It's Jon Raviv on for Jason this afternoon. Todd, in your travels to visit both employees and customers, can you just give us a little more sense on what the conversations are like, what the focus items are and what sort of actions items you're leaving those conversations with?

Todd Renehan - *Wesco Aircraft Holdings, Inc. - CEO and Director*

Yes. Well, the transparency not only goes to the shareholders. It goes to the entire organization about letting people know exactly where we are, what the issues are, where we're going and where we need their help to assist us in that journey. And we are focusing on employees being engaged, understand the mission, understand their specific position in the company and how they can help us either lead their teams better or drive a better level of service to focus intensely on improving the customer relationship, so that we can drive better financial returns for the company and for the shareholder. And they're happy with the transparency. They appreciate the candor. And I'm just trying to leave them with a sense of we need their help to improve on the things that we're focused on.

Jonathan Phaff Raviv - *Citigroup Inc, Research Division - VP*

And sort of the same question just on customers. I think in the release, you mentioned that you're renewing some deals, and there's some -- still some success there. But how -- what is the nature of those conversations like? And then again, what are you coming home with from those talks?

Todd Renehan - *Wesco Aircraft Holdings, Inc. - CEO and Director*

Yes. The same. The customers are letting us know where we're doing well, and they're very candid and quick to point out where we're not doing well. There are not any surprises for us on where we're not doing well. Typically, we have key performance indicators that we review with the customer. So we review those indicators, and we put the specific plans in place. We share with them those plans and our progress to the plan. They're happy with our renewed focus on the customer, and they want us to get better. We have good relationships. We have a good value proposition. We perform well, but they need us to be flawless. And as we get there, when we get there, they've committed to giving us renewed work and additional work around the world in their companies.

Operator

And your next question comes from Gautam Khanna from Cowen and Company.

Gautam J. Khanna - *Cowen and Company, LLC, Research Division - MD and Senior Analyst*

I have a couple of questions. The first question, I guess, is on the ad hoc sales, you mentioned -- obviously, the sales were down, but it also said the margin was down. So are you seeing -- is it that you -- so is it lower EBIT because you don't have the sales? Or is the actual pricing in the ad hoc market also starting to erode?

Todd Renehan - *Wesco Aircraft Holdings, Inc. - CEO and Director*

I'll start with that, and then I'll ask Alex if he wants to join in. The ad hoc market is changed, where we have some transfer of business to long-term agreements. We have less new platforms entering the marketplace. We have an increase in competition. And at the same time, we made some mistakes and did not put the right inventory on the shelf. So all of those things combined will lead to a lower margin. If we have to -- we have a product on the shelf, we have a tendency to get a higher margin. If we have to order it, then we have a tendency to put at risk the supplier delivery issue and then sometimes be more aggressive on the pricing. Our focus on ad hoc is to capture more of the opportunity that's out there by being more proactive and going after the market versus waiting for the market to come to us. And some of those additional initiatives that I mentioned are around pricing appropriately based on the market. That means sometimes higher, sometimes lower and that means following up those quotes with kind of a more aggressive approach to win that business. Alex, do you want to add anything?

Alex Murray - *Wesco Aircraft Holdings, Inc. - President and Chief Operations Officer*

Yes. I think, really, what I would add is that what we're doing with the teams, the work that I'm doing with the teams and asking them about what their behaviors are towards pricing and then see how we can modify that to improve margins. Without a doubt, we've been -- adopted a behavior, whereby we were not investing in products long enough to generate a higher margin. We were buying shorter because of our performance on our cash forecast. And we have, in essence, stopped that behavior, spoken to the team about that if this don't make sense to invest in a product and drive higher margins and improve our ability to see an effect in sales, then that's absolutely what we must do. So a lot of focus in that area as well as -- I mean, the business over the last year, in particular, has been struggling to maintain what it's guided, and that pushes the business as to what's up as you said, into certain behaviors. And we've been working with the team to reverse some of those behaviors because we think they're absolutely destructive for the business and were driving the wrong results.

Gautam J. Khanna - *Cowen and Company, LLC, Research Division - MD and Senior Analyst*

Okay. There's a lot of questions here, so I don't want to monopolize. But maybe you could comment on -- Todd, you mentioned kind of some of the investments and reductions were made in the wrong places under Dave's tenure. How much money -- how much sales do you think you left on the table on an LTM basis due to kind of misallocation of resources, be it a reduced sales staff or what Alex just mentioned in terms of not being proactive? What could it be if things go as you hope?

THOMSON REUTERS

Todd Renehan - *Wesco Aircraft Holdings, Inc. - CEO and Director*

Yes. In ad hoc -- well, let me back up. The cuts too close to the customer, what I'm referring to are cuts on the sales desk and cuts in the warehouse, which affected our performance to the customer. These are quote turnaround performance or chasing -- having to chase parts and having trouble getting product out the door. We had specific conversations with specific customers where it's cost us multiple millions of dollars in revenue. And we're immediately focused on getting that back by executing the initiatives that I just spoke about.

Gautam J. Khanna - *Cowen and Company, LLC, Research Division - MD and Senior Analyst*

Okay, that's helpful. And you also make reference on the slides, I believe, to lost business. Were there any re-competitions that were lost, i.e. just you lost a customer, what have you? Or is it more of what you just mentioned, which is the performance -- the lead times weren't great, and therefore it was an opportunity cost as opposed to a transition to another one of your competitors, for example?

Todd Renehan - *Wesco Aircraft Holdings, Inc. - CEO and Director*

Yes. It's a little bit of both. Most of the lost business that we've experienced is around ad hoc and is around smaller transactional LTA-type business. And that goes sometimes to competition, sometimes it goes direct to a manufacturer, sometimes people take it back in-house.

Gautam J. Khanna - *Cowen and Company, LLC, Research Division - MD and Senior Analyst*

Understood, okay. And one last one, Todd. I asked this of Dave when he came aboard, what is your view of kind of the secular pressures on the business given the maturity of the BASN program, given the, I would argue, intensified focus across the supply chain on reducing working capital. What do you think kind of the prospects of the growth of the industry that you serve look like over the next 5 years versus the last 5?

Todd Renehan - *Wesco Aircraft Holdings, Inc. - CEO and Director*

I think the more complicated the supply chain, the more pressure people have on their own profitability, their own working capital, plays directly into our sweet spot and value proposition. As one of the world's largest and leading supply chain companies for hardware, chemicals and electronics, that's exactly what we do which is drive costs out of our customers' business, drive working capital down and improve their overall profitability, reducing their supply base. I mean, to me, the more complicated this gets, the better off we are.

Gautam J. Khanna - *Cowen and Company, LLC, Research Division - MD and Senior Analyst*

I guess, what I'm -- that's a great answer. I'm just curious if you could comment on what do you think of the addressable market grows at for your business. I'm not asking for fiscal '18 guidance. I recognize that there's a lot to get your hands around. But when you look out over the next 5 years given build rates, given the trends you mentioned within the supply chain, what can the business -- this industry do -- your industry do in organic growth?

Todd Renehan - *Wesco Aircraft Holdings, Inc. - CEO and Director*

Yes. I think it's low single digits.

Operator

And your next question comes from Jeff Bronchick from Cove Street Capital.

Jeffrey Bronchick - *Cove Street Capital, LLC - Principal and Portfolio Manager*

And Todd, you're obviously the -- you're the new sheriff in town. You're a member of the board. And a lot of this mess was -- falls on your shoulders, wasn't necessarily created by you. But I was wondering, obviously, your -- you and Alex and team are doing what you're doing. But shouldn't there be a parallel path? I mean, the amount of whatever heaped upon the shareholder base since this company has been public in a consolidating industry that had smaller player, bigger customers, why and given the leverage that was heaped upon it by certain of your shareholders, why isn't the natural state of affairs and you're the new CEO and you're looking for a new CFO, why isn't the -- an obvious and parallel path of looking to sell the company?

Todd Renehan - *Wesco Aircraft Holdings, Inc. - CEO and Director*

Yes. As the CEO, I'm focused on improving the business. And we have a plan that I just gave you a high-level overview of that obviously has a tremendous amount more detail that we review regularly with the leadership team and with the board. So our job right now and our focus and our first priority is to turn this around. In those frequent interactions with the board, the discussions with the board, I know that the entire board is committed to doing what's best for the shareholders, and that includes evaluating any alternative strategies to maximize that long-term shareholder value.

Jeffrey Bronchick - *Cove Street Capital, LLC - Principal and Portfolio Manager*

So does that include -- I mean, have you guys -- has the board hired a banker and is reviewing the present value of what one can achieve today -- or the value achieved today versus the present value of your operating plan that you're developing?

Todd Renehan - *Wesco Aircraft Holdings, Inc. - CEO and Director*

No. We have not hired a banker yet. And again, my focus is on turning this thing around. But, like I said, as things progress the board's job, as I understand it, is to do what's right for the shareholders, and that means looking at alternatives if and when they come.

Jeffrey Bronchick - *Cove Street Capital, LLC - Principal and Portfolio Manager*

And I know our current CFO is on the call. But I mean, is there a -- what state of innings on a baseball analogy would you say a CFO search is in?

Todd Renehan - *Wesco Aircraft Holdings, Inc. - CEO and Director*

Yes. Early innings, Jeff. I've interviewed a few people. We're looking to interview a few more. And this process has been slow. Actually, it can't happen quick enough. Rick is here through the transition, and I'm pushing the process as fast as I can. And I'll give you all update as soon as there's anything to talk about.

Operator

Our next question comes from Ron Epstein from Bank of America.

Ronald Jay Epstein - *BofA Merrill Lynch, Research Division - Industry Analyst*

I guess, I'm kind of speechless, to be honest with you, right? I mean, the aerospace industry, maybe with the exception of widebody, is just kind of ripping right now. Suppliers pretty much across the board are doing pretty well. And my sense is you're earnest in your desire to fix it. But is this fixable? Like I mean, does this company need to exist? I mean, sincerely?

Todd Renehan - *Wesco Aircraft Holdings, Inc. - CEO and Director*

Yes. I get it. It's fixable. As I said at the beginning and a couple of times through my prepared remarks, a lot of this is self-inflicted. We have, over the past couple of years, attempted to transform the business maybe too much like a manufacturer. You can see the results of that have not worked very well. And I think we broke down some of the intrinsic value proposition that Wesco had provided in the past, primarily around its ability to stage and hold inventory and have the right people in the right place. And we hurt that, and now we're in the process of undoing that. And that means putting some short-term resources and people and inventory back in the game as we long term look at the processes and systems and drive costs out of the business through greater efficiencies. But it's fixable and it's definitely worth us being in the game. We wouldn't be the size we have, we wouldn't be adding business, we wouldn't be selling new business with the value proposition that we had if it wasn't worth being in the game.

Ronald Jay Epstein - *BofA Merrill Lynch, Research Division - Industry Analyst*

Yes. I mean it's -- yes, I hear you. It's just hard to think that there's just not some secular headwinds that are just really, really killing you guys. I mean, and not your fault, obviously, right, because you guys are new and you're really -- seems like going to try to do this. But I mean, how spectacular this thing went off the rails from when the company first went public, it's remarkable. And in terms of the hardware assets that you guys wrote down, what was that, right? So the chemical stuff was Haas, right? I mean, Haas has been a disaster since it happened. What was the hardware stuff that got written off?

Todd Renehan - *Wesco Aircraft Holdings, Inc. - CEO and Director*

Okay. I'll ask Chris to address that, if I can.

Chris King - *Wesco Aircraft Holdings, Inc. - CAO, VP of Finance and Global Controller*

Sure, I'll address that one. The hardware business was also in North America. We had to, with the drop in stock price and recent performance, relook at the forecast that underpinned the goodwill impairment test we did a year ago. Obviously, our 2017 results fell short of what we had expected back then. So it was a point in time valuation, reflecting much of the problems that Todd outlined today and not reflecting...

Ronald Jay Epstein - *BofA Merrill Lynch, Research Division - Industry Analyst*

So we did an inventory write-down? Like I'm just curious what was written down.

Chris King - *Wesco Aircraft Holdings, Inc. - CAO, VP of Finance and Global Controller*

Well, it was a goodwill impairment charge.

Ronald Jay Epstein - *BofA Merrill Lynch, Research Division - Industry Analyst*

On what?

Chris King - *Wesco Aircraft Holdings, Inc. - CAO, VP of Finance and Global Controller*

I think I see where your question comes from. When the Carlyle Group acquired Wesco back in 2006, it was a change of control, and there was goodwill related to the hardware business put on the balance sheet at that time. It's that goodwill that's the hardware impairment charge.

Ronald Jay Epstein - *BofA Merrill Lynch, Research Division - Industry Analyst*

All right. So this was a write-down of goodwill that got put on this when Carlyle bought it?

Chris King - *Wesco Aircraft Holdings, Inc. - CAO, VP of Finance and Global Controller*

Right.

Operator

And our next question comes from Michael Ciarmoli from SunTrust.

Michael Frank Ciarmoli - *SunTrust Robinson Humphrey, Inc., Research Division - Research Analyst*

Maybe just to stay on Ron's line of questioning here with write-downs. You continue to invest in inventory. The end markets aren't growing. Should we be concerned at all that there are write-downs coming within inventory given some of those widebody pressures, given some of the other weakness that we've seen in the marketplace, whether it's on biz jet or regionals?

Todd Renehan - *Wesco Aircraft Holdings, Inc. - CEO and Director*

Let me start that, and then I'll give that also to Rick. But based on our analysis right now, we currently have no plans of write-off -- of writing off inventory. And we book E&O adjustments as needed, and we evaluate inventory for obsolescence on a regular basis.

Rick Weller - *Wesco Aircraft Holdings, Inc. - CFO and EVP*

I'll just add to that a little bit, Mike, that we definitely have bought and built inventory in the last couple of years. That is all good inventory, might have been purchased a little sooner than we ultimately needed and in quantities greater to support new business ramp-ups. But it's good inventory. And as Todd said, we do evaluate obsolescence regularly and constantly review our excess and obsolete inventory and analyzing it. And there are really no plans for any future write-downs.

Michael Frank Ciarmoli - *SunTrust Robinson Humphrey, Inc., Research Division - Research Analyst*

Got it. And then just maybe, Todd, on the longer-term view. I mean, at one point, this business was generating high teens, low 20% margins, Haas came along, it dropped down to low double digits. Here we are in the high single-digit margins. How should we be thinking about the longer-term profitability of this business? Clearly, it's under pressure right now at kind of mid to high single digits. But internally, how are you guys looking at the profile? It seems to be a low single-digit organic growing market. What do you think normalized profitability is?

Todd Renehan - *Wesco Aircraft Holdings, Inc. - CEO and Director*

Yes. I'll start again, and then maybe give that back to Rick. We -- our expectations as we right this ship is to outgrow the market in that kind of mid-single-digit growth rates and improve the profitability to higher levels. But we're in the middle of our -- it's a little early for us to be predicting that right now. As you know, we're not giving any guidance specifically. And we're in the middle of our planning process for 2018, where we'll have a better indication of kind of where things are heading with the business ourselves, but I'll let Rick maybe give more color.

Rick Weller - *Wesco Aircraft Holdings, Inc. - CFO and EVP*

Yes. Just a follow-up on a couple of things. As Todd mentioned before, first and foremost is ad hoc. We addressed that issue that will turn to be a margin lift. We also mentioned SG&A, leveraging SG&A, being efficient. And the functions that support that are critical to the overall margin expansion. And then on contract hardware and new business that we're winning, focus on ramping that business up and enjoying the margin and contribution that come with it. Those would be the primary three biggest overall operating margin factors.

Operator

And our next question is from Gautam Khanna from Cowen and Company.

Gautam J. Khanna - *Cowen and Company, LLC, Research Division - MD and Senior Analyst*

Two other questions, I guess. One, first, Alex, you made reference earlier to maybe getting the sales force to focus on profitability and stuff like that. I was just curious, what -- maybe under the new regime, what are the new incentives? If you're going to tweak the incentives that you're implementing across the sales force, what's going to change?

Alex Murray - *Wesco Aircraft Holdings, Inc. - President and Chief Operations Officer*

Yes. It's not so much about adding incentives. It's more about removing restrictions. So I think definitely the sales team and the people on the desk were looking back to towards the business and saying that from a corporate level, we were restricting their ability to behave in what they consider to be the appropriate manner. So we've removed those restrictions. We'll flatten the organization. We'll allow people more autonomy at a regional level to make sound and solid decisions, which will lead to better profits. We always do consider at all times how we should be incentivizing our sales force. And we have moved certainly with the introduction of Haas more of our outside-type salespeople to a more commission-based-type structure. But at this stage, nothing significant in changing what we're looking for, for the sales team, more about getting out of their way and stop putting restrictions on them that were damaging.

Gautam J. Khanna - *Cowen and Company, LLC, Research Division - MD and Senior Analyst*

Could you give us some specific examples of the type of barriers that were in place that you're removing?

Alex Murray - *Wesco Aircraft Holdings, Inc. - President and Chief Operations Officer*

I think the simplest one to understand is really the ability to make an investment in inventory. The hardware business -- the hardware industry is now price sensitive to volumes. So therefore, you can drive higher margin by moving to the next break, the next quantity break. And because of our cash position and performance to our prior forecast on cash, we were restricting the team. So you end up in a more broker-buy-type situation, where you sell 100, you buy 100. And the margins, you can expect from that are in the low 20s. Whereas if you sell 100 and buy 400 to 500, and then be prepared for the sale the next time around, you can expect margins closer to the mid-30s or even the 40s. So it's about giving the sales team a latitude. And that latitude, the Wesco's sales team has enjoyed for decades and is the latitude that we removed over the last two years. So it's about putting that latitude back in place.

Gautam J. Khanna - *Cowen and Company, LLC, Research Division - MD and Senior Analyst*

Okay, that's interesting. I was curious if you could also talk about, to that point, are you, in fact, in a position now to get substantially better terms from your supply chain, the manufacturers, just given I'm sure they're pressured by these secular issues as well? Is your cost -- if you sell 100, buy 1,000, I mean, is that substantially better in terms of cost than it was maybe five years ago or two years ago, what have you?

Alex Murray - *Wesco Aircraft Holdings, Inc. - President and Chief Operations Officer*

I don't think that relationship or ratio has changed with time. There are so many of the commodities that we trade in, where you are incentivized from the manufacturers to buy longer. So that has always been in place and still in place today. We've spoken about what could we have done on our strategic sourcing in terms of making longer-term commitments to our supply base. That work continues, and we see that work as beneficial to Wesco. It's also beneficial to our supply base in that they get some stability and they get a long-term commitment from us. And that will ultimately lead to an improvement in margins. We have to work our way through from the contract pre-phase to where we're actually receiving that product at those beneficial prices and then ultimately selling that product in the marketplace before you see it in our financial results. But we still see that as a positive initiative and something we're continuing with in the business.

Gautam J. Khanna - *Cowen and Company, LLC, Research Division - MD and Senior Analyst*

Okay. Guys, I was hoping you could comment on where you are in the aftermarket, what percentage of sales, some bogey that they have now? And then also, what are you doing to kind of grow that business either via sales force investments or otherwise? Because that seems to be mostly an ad hoc market. So what's your strategy in the aftermarket?

Todd Renehan - *Wesco Aircraft Holdings, Inc. - CEO and Director*

Yes. First part of the question is the MRO market for us, aftermarket is about 6% of sales right now. The investments we're making, without broadcasting too much to all of our competition, is both in inventory and in sales team and sales leadership around the country to build up that pipeline, make the calls and penetrate that market. We are -- we think it's a big growth area for us. We value the size of the market at about $4.5 billion, and we're a tiny little piece of it. So it's upside for us that we're going to continue to pursue and invest in.

Gautam J. Khanna - *Cowen and Company, LLC, Research Division - MD and Senior Analyst*

Okay, that's good to hear. And one other thing, I just was curious. Do you guys have any view on what your exposure is still to the Boeing OE in-production aircraft fastener business? I.e. how much of sales go to the subcontract manufacturers to Boeing and Boeing itself that at some point, theoretically, could be in-sourced via the BASN program as a percentage of your sales today?

Todd Renehan - *Wesco Aircraft Holdings, Inc. - CEO and Director*

I don't have the percentage of sales wrapped up to Boeing or Boeing support. We have been competing with BASN for several years now. We have seen the worst of that impact being well behind us. We're just right now lapping the final impact of that one big contract we always talk about. And our value proposition to customers who don't want to use BASN is still attractive. And as a matter of fact, we sign business every quarter against BASN and folks who would rather deal with us than go through that process. So yes, it's still a strong value proposition against the BASN product.

Gautam J. Khanna - *Cowen and Company, LLC, Research Division - MD and Senior Analyst*

Todd, I asked the question and I don't mean to belabor the point, but I asked the question -- obviously, Alenia, you've comped through it, et cetera. But Spirit, in the last quarter mentioned that they came to an agreement with Boeing. I know they procure their fasteners directly, but they also buy in the spot market. I was just curious, should we anticipate that there is no further decrement to your business from BASN? Or should we assume that there's always going to be pressure, whether it's Spirit or some other person, that flows through over the next couple of years?

Todd Renehan - *Wesco Aircraft Holdings, Inc. - CEO and Director*

Yes. I think there's always going to be pressure. I mean, you mentioned Spirit by name. We're working specific deals with Spirit also. At the same time, our hardware content with Spirit is relatively small. But if it's not Spirit, it's somebody else. We're always going to compete. BASN is not going away. We don't think it is. And we think the best way to compete is to show our value to the marketplace and what we bring to the table.

Operator

And your next question comes from Jason Gursky from Citi.

Jonathan Phaff Raviv - *Citigroup Inc, Research Division - VP*

It's Jon again. I know, Todd, you can't give an overall time line. But within those four focus areas, can you give us some sense for what could be accomplished faster than others and what are some of the milestones we should be looking for over the coming months, quarters as you are -- as you will?

Todd Renehan - *Wesco Aircraft Holdings, Inc. - CEO and Director*

Absolutely. When we're talking about the margin improvement, revenue improvement, some of the training is already in play in terms of capitalizing on the market as best we can. So maybe that's kind of a medium term. We are already seeing improvement in our customer service and on-time deliveries from the beginning of the quarter to the end of the quarter. It's almost 100 basis point improvement in on-time delivery, and that's a direct result of starting to get more of the right products on the shelf, but more importantly, putting the people and the resources in place. So we're starting to see that quickly, and we'll continue to see that as those folks continue to get trained up and more efficient. The procurement initiatives are kind of a lead time away. So that one's going to be longer term. We've got to burn through existing inventory. As the new inventory comes in at better pricing, long-term agreements, then we'll start to see that. But that's a lead time away. And the cost efficiencies, there are some things that we have taken action on already in terms of layers, in terms of span of control, in terms of improving processes. So those initiatives to drive out costs will be quicker. The system changes, the consulting work that we're doing, those are going to take a little bit longer. So it's kind of a mix of all four of those areas, some short, some medium, some longer term.

Jonathan Phaff Raviv - *Citigroup Inc, Research Division - VP*

Great. And then just going on -- just thinking about the next call, do you feel like you'll be confident in a couple of months here to give us some FY '18 -- or excuse me, some four-year targets in terms of guidance or not signing up for that yet?

Todd Renehan - *Wesco Aircraft Holdings, Inc. - CEO and Director*

Yes. We're not really weighing in on that yet. I think the more we go, the more comfortable we get. We've got to, like I said last time, put some forecasts out there that we hit internally before we start communicating to the rest of the world. So for right now, we're in no position to say when we will give guidance again if ever and/or what form it might look like.

Operator

And this concludes our question-and-answer session. I'll turn the call back over to Jeff Misakian for final remarks.

Jeff Misakian - *Wesco Aircraft Holdings, Inc. - VP of IR*

Okay. Thanks, Adrian. On behalf of everyone at Wesco Aircraft, we'd like to thank you for your participation today. We appreciate your interest in Wesco, and look forward to speaking with you all again soon. Have a good evening.

Operator

Thank you. Ladies and gentlemen, this concludes today's conference call. Thank you for participating, and you may now disconnect.