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PRESENTATION

Operator

Welcome to the Wesco Aircraft Holdings Second Quarter Fiscal Year 2017 Earnings Call. My name is Danielle, and I will be your operator for today's call. (Operator Instructions) Please note that this conference is being recorded. I will now turn the call over to Jeff Misakian. Jeff, you may begin.

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

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

We've 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, our newly appointed Chief Executive Officer; and Rick Weller, Executive Vice President and Chief Financial Officer. Alex Murray, also recently appointed to the position of President and Chief Operating Officer, is 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.

Before we get to management's remarks, Adam Palmer, Wesco's presiding director, would like to say a few words about the recent management change. Adam?

Adam J. Palmer - *Wesco Aircraft Holdings, Inc. - Presiding Director*

Thank you, Jeff, and thank you, everyone, for taking time to join the call today. While unusual, the board thought it was appropriate to say a few words before turning the call over to management to discuss the quarter.

As Wesco has already announced, on April 26, Todd Renehan was appointed Chief Executive Officer and Alex Murray as President and Chief Operating Officer. Todd has also been appointed to the Board of Directors and Dave Castagnola, previously President, Chief Executive Officer and a member of the company's Board of Directors, has retired from these positions. We appreciate the leadership Dave brought to Wesco and some of the achievements during his tenure, including the completion of the integration of the Haas acquisition. We value the professionalism he brought to Wesco, and the company will continue to utilize many of the processes that he's implemented.

The board recognizes, however, that the business has not been performing to expectations, whether it be the expectations of the board, of investors or, most importantly, of our customers. Over the past several quarters, we have witnessed stagnant to declining sales and gross margins despite a number of significant contract wins and strong renewal activity. As a board, we are committed to delivering shareholder value, and we believe that Todd and Alex are uniquely capable of addressing our current challenges and returning the company to a path of consistent growth and increased profitability.

As one of the world's largest providers of supply chain management and distribution services to the global aerospace industry, Wesco possesses a number of attractive attributes, which should enable it to deliver value to investors, most notably are its strong and diverse customer relationship, its breadth of offering and scale of its business, leading to what should be superior procurement capabilities in the unique combination of products and services and its leverage to an attractive aerospace end market.

Todd has demonstrated his ability to drive revenue growth and lead a complex global enterprise while he served as President of Haas and then seamlessly transitioned to leading both chemical and hardware sales as Wesco's Chief Commercial Officer, while Alex is a 17-year Wesco veteran who has deep knowledge of the business and understands how to advance Wesco's strategies and operational execution. Their complementary skills and strong working relationship make us confident that they are the right people to lead Wesco forward today.

Wesco is a unique business that requires a blend of tight process control and execution management, combined with an entrepreneurial attitude and true partnership with its customers and suppliers. We believe Alex and Todd have the necessary experience and judgment that will allow them to balance these requirements in order to drive a superior value proposition for customers and maximize the earnings potential for shareholders. We also believe that their understanding of Wesco's history will enable them to combine the flexibility and customer-centric culture that has defined Wesco previously with some of these new processes and operating controls.

Over the past couple of weeks, we've had significant engagement with Todd and Alex as they've transitioned into their new roles and believe they're off to a strong start, identifying ways to optimize the organization to better focus on our customers while integrating the various functions to ensure that the senior leadership team is working together more effectively.

The board is looking forward to seeing the business progress as more resources are dedicated to driving ad hoc sales through our branch channels, investment in our e-commerce capability increases and our leaders spend more time in the field working directly with our customers to support their business needs and leverage these opportunities for growth. We all believe Wesco's current strategy and that its transition and renewed focus is in the best interest of all constituents and will lead to the best opportunity for Wesco to maximize its potential value for all of its stakeholders.

With that, I hope that you will join me in congratulating Todd and Alex on their new roles, and we'll turn the line over to Todd. Todd?

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

Thanks, Adam. I'd like to start by saying that while we're disappointed with our recent performance, Alex and I are honored to have this opportunity to lead Wesco. We continue to believe that the company has a bright future with talented and committed employees and an enduring value proposition in the marketplace. While Wesco has made progress in a number of areas, including our internal processes and new business wins and contract renewals, it's clear that our recent performance has fallen short of expectations.

The company has undergone a lot of change over the past 2 years. While a number of these changes were needed, in hindsight, we tried to change too much, too fast. This has taken our focus off the customer and impacted our business. While we plan to keep many of the processes that have been introduced, they need to be employed in a way that connects to our business philosophy and drives better performance. We are renewing the Wesco customer-first culture that delivered world-class service and our unique value proposition to our customers. We believe this culture will foster long-term relationship-driven value rather than short-term actions that have, at times, adversely impacted our service levels and subsequent business opportunities.

In a nutshell, we believe the company has become too inwardly focused, which has impacted relationships with customers and at times led to decisions which made sense in the short term but may have had other adverse consequences. This has muted the pace of new business wins and contributed to the decline in ad hoc sales while also pressuring gross margins.

Nearly 50% of our ad hoc sales comes from our strategic customers. If we're not performing to their expectations, it's going to have an impact on our opportunity to earn additional business. We're taking action to ensure Wesco is the first call our customers make when they need more assistance with their supply chain needs. We've already announced major new wins and contract renewals with many of these customers. We talked last quarter about the level of new wins, and we continued to add more business in the second quarter.

Over the last 18 months, we booked new business wins of more than $140 million in net sales on an annualized basis. We still believe that sales in fiscal 2017 will benefit from these new wins at a consistent level with what we told you in the previous quarter. Wins in the second quarter won't likely contribute to revenue until fiscal 2018. And I know from my discussions with many of our customers that they're ready to give us more work as we improve our performance. Wesco's performance rates are among the highest in the industry, but we do so much volume with these customers that a small hiccup can meaningfully impact their production. And by increasing our external focus, we believe we'll be able to improve beyond even our current standards.

Implementations of new business continue to make progress with more revenue contribution in the quarter, which Rick will talk about in his remarks. Our successful completion of implementations will be key in demonstrating our commitment to our customers and service excellence. While we're making progress transitioning this new business, we've yet to see the full potential of the revenue ramp. And as a result, sales from new business are net yet overcoming the increased cost to support the new contracts.

As we've mentioned, SG&A expenses and inventory investments are being incurred ahead of receiving the full revenue benefit. We need to fix our execution on ad hoc revenue to make sure we're winning our share of the market, while at the same time, developing faster, more effective penetration strategies for the aftermarket. It's clear that we've struggled to improve ad hoc performance for the past 2 years, including another decline in the second quarter. Some of this is due to external factors such as a lack of new industry product introduction and stable supplier lead times. But part of our ad hoc challenge also has been self-inflicted, caused by our own inconsistent pricing, service levels, response times and product availability.

In aftermarket services, we've made some progress, but the pace needs to quicken and we need to improve our execution in this channel as well. We're also not seeing the margin expansion we originally expected this year due to lower ad hoc sales and a higher proportion of chemical revenue. And while we're making progress with new business implementations and strategic sourcing initiatives, it takes time to achieve the related margin benefit.

SG&A is also running ahead of the prior year, further impacting our margin performance as we continue to bring on additional resource, including staff to manage JIT programs at the customer sites to support the new business. These costs are required to ensure performance but they're incurred in advance of recognizing the full revenue benefit. The bottom line is we simply did not forecast appropriately the level or the timing of investment required for our new business expansion, either from an expense or working capital standpoint. This highlights another challenge that we need to significantly improve our forecasting capabilities, redesign the processes involved and set appropriate expectations. We're talking -- taking action now to do just that and will make further changes in the months ahead. Rick will talk more about this in his remarks.

The impact of these challenges is clearly seen in our fiscal 2017 year-to-date results, with lower sales, declining gross margins, higher SG&A expense all putting pressure on profitability. And we still have more work to do on improving cash flow generation.

So now I'll ask Rick to walk you through the results for the second quarter. Rick?

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

Thanks, Todd. Please turn to Slide 3. Net sales in the fiscal 2017 second quarter of $364.6 million decreased 3% compared to the same period last year. Foreign currency translation had a negative effect of 2.5% on fiscal 2017 second quarter sales, primarily from the British pound. In addition, net sales in the last year's second quarter included a $9.8 million sale, which did not recur in fiscal 2017 related to the termination of a large commercial contract in fiscal 2015, as previously disclosed.

Constant currency sales, excluding those related to the large commercial contract, were 1.9% higher year-over-year, primarily due to approximately $16 million of sales realized on our new contract business, partially offset by a decline in ad hoc sales. As Todd mentioned, we have more work to do in terms of our ad hoc execution. Ad hoc sales also were impacted by the production schedule changes made by the commercial OE customer we discussed last quarter.

Please turn to Slide 4. Gross margin declined 120 basis points year-over-year in the fiscal 2017 second quarter, primarily due to a greater proportion of chemical sales in the second quarter as well as lower ad hoc sales and margins. SG&A as a percent of sales increased 100 basis points year-over-year in the second quarter, reflecting higher expenses and the lower level of sales. SG&A expenses were $1.6 million higher year-over-year in the quarter. The increase in SG&A expenses was primarily due to higher people-related and systems costs of $4 million, which included an investment to support new business of approximately $2 million, partially offset by lower professional fees of $1.2 million and bad debt expenses of $1.2 million as well as currency translation impact of $1.7 million. The lower gross margin and higher SG&A as a percentage of sales drove a 220 basis point decline in operating margin in the second quarter.

Net income was $0.18 per diluted share in the fiscal 2017 second quarter compared to $0.24 per diluted share in the same period last year. Adjusted net income was $0.21 per diluted share compared to $0.29 per diluted share in the same period last year. Adjusted EBITDA was $39 million or 10.7% of net sales in fiscal 2017 second quarter. This compares to a $50.8 million or 13.5% in the same quarter last year.

Please turn to Slide 5. Sales in North America were down 2.3% in the second quarter compared to the same period last year, primarily due to the onetime JIT sale to the large commercial customer in last year's second quarter as well as a decrease in ad hoc sales. This was partially offset by the increase in sales realized on our new contract business.

North America's gross margin was down 40 basis points year-over-year in the second quarter, primarily due to lower ad hoc and greater proportion of chemical sales, partially offset by reduced inventory charges. SG&A as a percentage of sales was up 110 basis points, primarily due to higher people-related costs to support new business. Lower gross margin and higher SG&A as a percent of sales drove an operating margin decline of 150 basis points in North America in the quarter.

Turn to Slide 6. Sales in the Rest of the World segment declined 7% in the second quarter or up approximately 5% on a constant currency basis, primarily due to higher contract sales. Gross margin in the Rest of the World was down 430 basis points year-over-year, primarily due to a change in inventory adjustments and the effect of greater chemical sales on gross margin. SG&A as a percent of sales was up 20 basis points year-over-year in the Rest of the World segment. Lower gross margin primarily drove a 450 basis point decline in operating margin in the Rest of the World in the quarter.

We established a new U.K. legal entity on April 1, combining legacy hardware and chemical entities, which will allow for operational efficiency, leverage and improved customer service across multiple commodities. The appropriate functional currency for the new entity is the U.S. dollar, which we expect to reduce the company's translational currency exchange risk going forward.

Please turn to Slide 7. Inventories increased $23 million in the second quarter of fiscal 2017, primarily for new business. The increase reflects investment needed to support new products and higher volumes of existing products under the new contracts. We will continue to invest to support our customers, while at the same time, increasing our focus and process around scheduling deliveries closer to the dates they are needed. We continue to work on improving working capital management.

Total debt was $855 million at March 31. We borrowed a net $18 million on the revolver and repaid $5 million of our term loans in the second quarter. We amended our credit agreement in March, which, among other things, changed our leverage requirement ratio to provide greater cushion. We ended the fiscal 2017 second quarter with a leverage ratio of 4.41x adjusted EBITDA compared to a requirement of 4.60. 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.

Please turn to Slide 8. Net cash used in operating activities was $6 million in fiscal 2017 second quarter compared with net cash provided by operating activities of $4 million in the same period last year. The change in operating cash flow primarily reflects the investment in inventory to support new business. Free cash flow usage was $9 million versus $2 million in the second quarter of last year.

As Todd mentioned, we are taking steps to improve our financial planning and analysis function. For example, we are bolstering our leadership of the function, doing a better job of connecting it to our business functions and ensuring that each element of planning is validated throughout the organization. While we have a lot of work to do, we are committed to improving our forecasting process and establishing appropriate expectations for the business.

Now I will turn the call back to Todd for closing remarks. Todd?

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

Thanks, Rick. You've heard us present an open and balanced assessment this afternoon of where we think the business stands and our disappointment with our current financial performance. You'll find that our approach to communications will continue to be transparent in the future. We've done a number of things right in the past few years but know that there's much work still to be done. We believe that Wesco's strategy and value proposition to our customers remains very much intact as evidenced by the new business our customers continue to give us. Going forward, we intend to renew our customer-first culture with the kind of superior service that gave Wesco such a strong reputation in the marketplace, and we'll work together as one team to achieve this goal, improving transparency and open communication.

Alex and I will be making adjustments to our organizational structure to make us more nimble and bring us closer to the customer. As Rick mentioned, we're also rebuilding financial planning and analysis to improve our forecasting process, deliver more predictable results and set appropriate expectations. This is a process that will take some time to complete. And until we do, we are suspending our public guidance. We will review this decision at a later date, at which point will decide on the appropriate form of forward-looking information to provide in the future. Whatever form that may take, we want to start from a position of achieving forecast internally on a consistent basis.

As I said earlier, we believe Wesco has a bright future with a very talented and committed group of employees who are working hard to ensure the company's success. And we've talked a lot about a number of actions we're taking to improve our performance. We know that talk is easy, and we know that we need to demonstrate progress with our results, and we plan to work diligently to earn your trust again.

I'll turn the call now over to Jeff to direct the Q&A.

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

Thanks, Todd. With that, we will open the Q&A period. Todd, Alex and Rick are available to answer your questions during this time. Danielle, may we have the first question, please?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We do have our first question. Our first question comes from Jason Gursky of Citi.

Jason Michael Gursky - *Citigroup Inc, Research Division - Director and Senior Analyst*

A couple of questions here for you. First, on the comments around the customer-first focus. Todd, I was wondering if you could just walk us through some tangible examples of what that means exactly to you and how quickly you can recoup that and get those ad hoc sales back on track.

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

Right. Thanks, Jason. To me, that means the organizational design that Alex and I are putting forward will face the people externally to the marketplace to be able to spend more time with customers, including Alex and myself. And that cascades down through the entire organization, and at the same time, free up our people with that more nimble structure to be able to solve the customers' problems more quickly than we currently do in our functional silos. So it's to really dramatically improve the level of attention and focus and problem-solving and execution that we give our customers on a daily basis.

Jason Michael Gursky - *Citigroup Inc, Research Division - Director and Senior Analyst*

Okay, great. So it sounds like a medium-term kind of fix here. The muted pace of new business wins that you mentioned, is it that the pipeline overall for the industry looks like it's not as robust as it once was? Or is this the case that you're not winning the share that you have had in the past? And if it's a question of share, maybe you could describe just a little bit about what's contributing to those losses, is it pricing? Is it kind of the T's and C's of the deal? Just a little bit more color around this pace of new business, whether it's industry, company specific and what are the drivers going on here.

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

Got it. Okay. Let me see if I can take those one at a time. The underlying market conditions are relatively flat. Our internal pipeline -- when we talk about pipeline, it's what we've got working in our sales pipeline. Our pipeline is very healthy and remains very robust. On our strategic customers, we are not losing market share. We have an unrivaled value proposition that we bring to the marketplace, and we're solid with that value proposition. On the ad hoc side, it's a very competitive market. Some of the dynamics have changed. There's less disruption. There's better lead times from the suppliers. There's -- competition is always aggressive. And as we perform, we win. If we fall down, we'll lose those ad hoc customers and we'll lose LTA. Just like our competition, if they fall down, then we take the business. The pricing in the marketplace has been relatively stable. So it's not a pricing thing, it's not a T's and C's thing. It's really us executing around ad hoc and around LTA and continuing our performance on our strategic customers.

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

I think I would add a little bit, too. Our strategic customers have came and told us on many occasions, they have more to give Wesco. We're not losing out to our competition. But most of our customers still continue to do many things themselves, whether it's additional commodities or additional services. And they have came out and then told us that they have more to offer, they have more to give Wesco significantly more, but we have to show them that we've got an ability to keep pace. And that's why we're doing well with our new business. We still could get even more and do better if we can ensure our customers and give them the confidence that we could keep pace with what we've got. And we've still got capacity to give them, if you like, a stable and enduring level of high service.

Jason Michael Gursky - *Citigroup Inc, Research Division - Director and Senior Analyst*

Got it. And then last one for me. Todd, you mentioned elevated cost ahead of revenue ramps on some of the wins that you had over the last year or so. Is the cost structure correctly aligned at this point for the long-term future of the business? Or is there some self-help here that we could get engaged with that would help drive operating margins perhaps a little bit higher here over the near to longer term?

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

We are looking at both. We're doing line item reviews on our entire company SG&A. We're going to bring cost in that makes sense to support the long-term growth of the business, but we're also looking at each function to determine where we can continue to drive cost out and become more efficient and then more profitable.

Operator

We have our next question. Our next question comes from Gautam Khanna from Cowen and Company.

William Daniel Ledley - *Cowen and Company, LLC, Research Division - Associate*

This is Bill Ledley on for Gautam tonight. I wanted to follow up on your point about pricing. You mentioned it's been relatively stable in the marketplace. Is that more on the LTA side and the ad hoc has gotten more price competitive? And to that point, if you are seeing shorter lead times, is that out of the distributors or out of the fastener OEMs?

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

Yes. When we referred to the pricing competitiveness, it is around the ad hoc market and the LTA market. And my point around lead times is the supplier -- the manufacturer's lead times have come down, and that can put pressure on distribution. But really, our opportunities are still very, very large, and we need to just capture more of our share.

William Daniel Ledley - *Cowen and Company, LLC, Research Division - Associate*

Okay. And then to that point, have you identified anything sort of in your reviews specifically that can help kind of fix the ad hoc weakness? And to that point, in your strategies for the aftermarket, I think you mentioned that you're kind of evaluating it. But anything new on that initiative?

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

Yes. The biggest thing for ad hoc for us, again, is we've got a lot of opportunities coming in. We're going to spend more time in the field with the leadership and with the customers developing a broader relationship. Again, those silos being eliminated are going to help us have a better speed to market to fix where we fall down. And the -- we're going to increase our efforts and our pace around introducing e-commerce as well as ways to address that large, fragmented market, if you will, in the ad hoc world. And that means having the right parts on the shelf, increasing our list pricing and standardizing our processes to improve our service and response times.

William Daniel Ledley - *Cowen and Company, LLC, Research Division - Associate*

Okay. And then just one last one for me. On the FP&A functionality, is sort of the sudden weakness in Q2, is that a lack of -- not being able to see the market? Or is it not being able to kind of react from a planning standpoint? Just kind of what are sort of the major challenges there? And then what are you guys looking to really change there?

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

Yes. Bill, it's a couple of things to follow up from what you're -- we're saying. It's really being better at understanding the market, build rates, growth assumptions that we're putting into the revenue plan and projections, being better connected to all the business functions. And we'll look up the information that reflects what people in the field are seeing and that we're experiencing and make sure that's connected back to the forecast. There's a lot to do there. It's more than 1 quarter forward, but that process has already started. And ultimately, we need to deliver more predictable results.

Operator

And our next question comes from Myles Walton of Deutsche Bank.

Myles Alexander Walton - *Deutsche Bank AG, Research Division - Director and Senior Research Analyst*

I was hoping to start on the side of the -- making the business customer-first focus. And sometimes that means having a lot more availability of your parts being on time and which means inventory levels. And so the real question is around cash flows over the near term as you're moving in this direction, being more customer-first focused, are you going to be in a significant investment cycle in inventories such that you're going to have to go back and renegotiate your debt covenants that you just negotiated a couple of months ago?

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

Yes. Myles, this is Rick. Two things. First, getting a better sense of our long-term rates for conversion of the new business, what that higher revenue will lead to in terms of collections is a very important part of this free cash flow conversion measure forward. We're investing in the inventory to support that new business now and matching it up with the realized revenue that Todd was referring to. And the run rate growth revenue will really be a part of that. The second part of it is continue with just -- with suppliers the min/max quantities that we need to service, replenishment for existing business is another component of that. And to the debt covenant question, we did just amend our debt to provide more cushion and really looking at the forward forecast for inventory and making sure that we're really managing through all of our working capital, including inventory, to ensure that we're in compliance forward.

Myles Alexander Walton - *Deutsche Bank AG, Research Division - Director and Senior Research Analyst*

But I mean, if I look at it, you're already at -- you're 4.41 here in the quarter. And obviously, the EBITDA, going forward, you're going to be anniversary-ing some quarters that were probably better than what we're going to see over the next couple. So you're comfortable that the ones you just set up are good for the remainder of the year?

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

Well, keep in mind that the 12-month trailing EBITDA number does allow for us to adjust some add backs. And so the combination of those things get us into a situation, we're not providing, obviously, guidance and -- along those lines. But that's something we're going to continue to work and monitor.

Myles Alexander Walton - *Deutsche Bank AG, Research Division - Director and Senior Research Analyst*

Okay. And Todd, because we have you, from a Haas perspective, just kind of under the surface, I think last year, it was about $600 million in chemical sales, similar to the year before that. It sounds like Haas is actually growing in '17, if I'm thinking about it right. Can you comment on, a, is that right? And also the margins when Haas originally came into the business were kind of 7% or 8% EBITDA margins. Have those expanded, contracted, are they the same?

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

Yes. The growth rate on the chemical side of the business should be flat to up slightly, but the contribution that you're referring to on the margin side is also about flat to up slightly. So we're starting to see some good growth lately with our large strategic customers on the chemical side, but it's flat to slightly up.

Myles Alexander Walton - *Deutsche Bank AG, Research Division - Director and Senior Research Analyst*

Okay, okay. And the cost side, I guess, I'm just trying to understand, you had some roll-in of costs that -- I guess, people costs. And so I'm just curious, are these temporary people cost? Or are these people costs that facilitate the contracts that you have and you're -- they're just part of the new contract structure? Or are these expedited people costs?

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

Myles, it's people costs associated with the new business. So a lot of the new business that we have won means that we have to stand up a new forward warehouse in a new geography. And we are providing people on site in the customer's operations as well as people in those forward warehouses doing the picking and distribution of the products. So they are permanent people in that sense, and they're associated with new business.

Myles Alexander Walton - *Deutsche Bank AG, Research Division - Director and Senior Research Analyst*

Okay. Okay. And just one last clarification. The ad hoc business in the quarter, was it down mid-teens on a reported basis? Or can you give color as to the level of decline it faced?

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

Yes, sure. The ad hoc was down kind of mid-single digits in the quarter.

Myles Alexander Walton - *Deutsche Bank AG, Research Division - Director and Senior Research Analyst*

In dollars or percent? Sorry.

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

Percent.

Operator

And our next question comes from just Jeff Bronchick from Cove Street Capital.

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

So I don't -- I'm going to, I think, speak for a lot of people, and I'm not sure I understand a thing that was said here today, in the sense of we've been hearing for 6 months and it seems to be what you're talking about we hear record new business wins and renewals and we see more inventory on the balance sheet, we see more people being hired to support this business. We've heard this story that I think is strategically correct that this business has an upfront cost that hits later, and yet at the same time, we're hearing that, we're not customer focused. So we're signing new business, we're putting up more inventory for them, we're hiring people to help them and yet that we're not somehow customer oriented. And secondly, I don't understand how you cognitively dissonance say, "we want a more predictable, forecastable business," which I thought was the kind of the point of the last couple of years of fitting a more professional organization into a very complex customer supply chain. And it's de facto being less ad hoc business. And I don't understand how wanting or desiring more ad hoc business is going to make anything more forecastable, if that is a desire. And I just -- it's a giant piece of confusion here that you've just kind of circled over and over again. And maybe if you'd like to take another shot at it by saying exactly what the board or current management really thinks was wrong with the past 2 years and what really do they think changes they're going to make over the next whatever, 2 years, to right the ship as they see it.

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

Okay. Let me start on that. And first of all, I appreciate the frustration and understand it completely. We have always been customer focused, and we're not saying that we are not and we're not saying we don't do a good job. We provide a fabulous service in the marketplace. I think what we're saying is the volume of -- the volume that we do with our large customers is so great with these world-class aerospace and defense companies that even at 99.5% performance, we make too many mistakes for them and can hurt their production. So what we're saying is we need to raise the game on our customer service. We feel that a more externally focused organization is going to help get us there. And as we do that, they personally told me, that there's room to grow. The predictability of the business needs to improve. And granted we might have been working on it for the past couple of years, we had the wrong leadership in, we had some disconnected direction, and there were some disconnects between the field and the group and the executive team that is already underway to improve. And we're appropriately adding the resource to get that right. So we didn't get it right, but we're going to get it right. The ad hoc is we're not saying that we're desiring -- we're desiring more of the share of the ad hoc opportunities that come at us. So we get inquiries and calls and emails to -- that we need to react better on and we need to provide a better level of service that will drive our ad hoc business, which will improve the margins of the entire company. What went wrong is we were internally focused. We spent a lot of time, and that cascaded throughout the organization. And that developed silos, which affected teamwork and affected customer service and customer focus and accountability. And there were disconnects, like we said, between some of the functions and the processes were driving the business versus us driving the process. So what we're trying to do right now in the first 1.5 weeks here is get to those top priorities and get that cleaned up.

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

And given that you've signed a fair amount of business over the last 6 months, and this business, whatever, comes in with a lag post the initial inventory and body setup that -- is that still the case? Or frankly speaking, there was just simply not enough attention paid to the actual economics of what was signed and you'll have to live and deal with it?

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

No. No, not at all. We do a complete, we call it a BCA, business case analysis, on every single deal that we do over a certain level, so anything of -- any magnitude. And it's the analysis over the entire term of the deal where we look at revenue, cost of goods sold, margin, SG&A, profit, ROI, what CapEx we need. These deals are good deals, and they will be accretive to the business. The model, it's a lag. And the costs come in sooner with people and inventory and the revenue spreads outs further. And we did a lousy job of forecasting and predicting those 2 dynamics.

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

And maybe I just have one last question. So really when you -- someone mentioned about Haas and their growth and margins that -- about strategic customers. Really, what is the strategic -- what is the overlap of these strategic customers between legacy WAIR and Haas? And when you really step back and look at it, does it make any sense whatsoever to run Haas and WAIR as "one" vis-a-vis letting them best run themselves as just separate entities within the Wesco brand? Has that been a problem? Because this is -- to us, there never seemed to be really any connection there.

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

Yes, there is. There is a connection. And when you talk about our top 30 strategic accounts that drive a majority of our revenue, there is a lot of overlap, and our value proposition and the original business case to make that acquisition was to leverage that overlap. And we have several large opportunities. First of all, we have several wins that we've already announced that cross product lines over those large strategic accounts. And we have several still in the pipeline that are broad multi-product, across-the-portfolio opportunities to continue to grow with these customers. And we talked about should it be separate entity, should we run these things that way, and we don't think that, that's the right thing to do.

Operator

We have our next question. Our next question comes from Carter Copeland of Barclays.

Phillip Carter Copeland - *Barclays PLC, Research Division - Associate Director and Senior Analyst*

Just a couple of them. The comment about the market conditions being flat, I just wondered what -- how that calculation kind of played out. It would seem that, clearly, the comment around ad hoc was the down mid-single-digit number. But the -- clearly, we've heard from some of your suppliers around the industry about a destocking impact that's out there. I just wondered if you might clarify that a little bit for us. When you say market conditions, is that inclusive of transitions to JIT and whatnot? Because it would seem that the market should be down now. I just wondered if you could help us with that.

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

Yes. Let me take a stab at that, Carter. First, I would say that if you look at the overall contract business, the chemical part of that business was up kind of mid-single digit. And that's primarily the military side of that business, specifically things like F-35 production are really kind of driving that part of the business. Hardware overall was up low single digits around LTA contracts and pretty flat on the JIT contracts. And that's across a host of customers that they are really driven by consumption on their lines and their respective build rates. So overall, I think in the hardware business, you've got to look at both the demand and the overall growth is really kind of coming at this juncture more from new business than it is from the existing contracts.

Phillip Carter Copeland - *Barclays PLC, Research Division - Associate Director and Senior Analyst*

Okay. And to that end, if you just -- it sounds like there are -- if you were to think about this in cash return terms or, I guess, profitable business from a cash standpoint, Rick, it clearly sounds like there's -- some of the business going out the door, which clearly has favorable cash profitability characteristics with it and the growth is coming from business that has yet to have any of that favorable cash dynamic. What is the -- I guess, your expectation around when that -- when it's possible that those could flip the other direction? Is this a multiple quarters or multiple years kind of relationship we should think about?

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

Sure. Particularly in contract hardware, to reach a full run rate of revenue is a fairly long amount of time, 9 to 12 months or, in some cases, even a little bit longer than that. And the reason for that is we have to burn through the customer's inventory before we get to full bin replenishment cycle into that customer's site. And so for that reason, it's a lot -- a longer period for us to get the full inventory benefit of those ramp-ups.

Operator

And we have our next question. Our next question comes from Sheila Kahyaoglu from Jefferies.

Sheila Karin Kahyaoglu - *Jefferies LLC, Research Division - Equity Analyst*

I just want to talk about ad hoc sales a little bit more, if that's okay. From my understanding based on pro forma numbers on Haas, I believe, ad hoc declined low single digits over the last 3 or 4 years. Just, I guess, is there any way you could quantify in percentages or however you'd like what the ad hoc lost sales are? Just trying to understand where this business could level off.

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

First, and I'll let Rick think through that, the comment about Haas in the chemical side and ad hoc, ad hoc was a very small percentage of the overall Haas business and then, therefore, an even smaller percentage when we bring Haas into the fold of Wesco. And in terms of your lost -- I'm not sure I'm following the question around the loss, Sheila.

Sheila Karin Kahyaoglu - *Jefferies LLC, Research Division - Equity Analyst*

Like you mentioned that customers have come up to you and said that they would give you more business, but you're not performing up to par. And I'm assuming that's some ad hoc lost business. I'm just trying to understand what -- ad hoc is currently 25%. You think it could have been 30% if it grew in line with long-term contracts. But just trying to understand how much the ad hoc decline is, I guess, is my core question. And where are these sales being lost? Is it 5 concentrated customers? Is it certain customers that need it? Just...

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

All right. Okay. Two other things maybe I would say to that. Our largest strategic customers generate more than 50% of our ad hoc business. And what I think the comment was is as we do a great job with those strategic customers, you get the right of first refusal on that ad hoc business. If we fall down at all, you don't necessarily get that ad hoc call. And that has cost us a little bit of business. In terms of percentages, if you look at the ad hoc decline year-over-year constant currency, it was down 5%. It was up Q1 to Q2 about 4%, but that's only kind of percentage that I would be able to give you in terms of what drove that.

Sheila Karin Kahyaoglu - *Jefferies LLC, Research Division - Equity Analyst*

Sure. And I guess, is there any way you could quantify what the profitability is with the ad hoc sales over the long-term contracts? Is it fair to say they are 25% where maybe the contract business' side? Just trying to gain an understanding of what's driven so much of the margin compression as well.

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

Yes. Sheila, this is Rick. Ad hoc margins are typically higher than our contract margin business. And so the challenge is that when ad hoc declines, it has an impact and puts pressure on the overall company margin. But even that notwithstanding, ad hoc margins themselves with the competitive nature of the process itself and what -- it's taking for us to continue to win orders and bring that business in has also put some pressure on the actual ad hoc margins. So the gap between contract and ad hoc has narrowed a bit.

Sheila Karin Kahyaoglu - *Jefferies LLC, Research Division - Equity Analyst*

Okay. And then last question, and this isn't probably one of your first priorities. But in terms of the aftermarket business, can you size it? And how do you plan to grow that business?

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

The aftermarket itself is a large opportunity that we are very small in. I don't think we give the specifics in terms of how big aftermarket is for us. In terms of what we're doing about that, these aftermarket customers require a fast turnaround. They require quick pricing. They require a better e-commerce solution. They require us to be able to get things in and out of our system very quickly, and those are the things that we're working on to penetrate that market further in order to grow that bigger than where it is today.

Operator

And I am showing no further questions at this time.

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

Okay. Thanks, Danielle. On behalf of everyone at Wesco Aircraft, I'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. Thank you for participating. You may now disconnect.