

THOMSON REUTERS STREETEVENTS

# EDITED TRANSCRIPT

WAIR - Q3 2018 Wesco Aircraft Holdings Inc Earnings Call

EVENT DATE/TIME: AUGUST 02, 2018 / 9:00PM GMT



## AUGUST 02, 2018 / 9:00PM, WAIR - Q3 2018 Wesco Aircraft Holdings Inc Earnings Call

### CORPORATE PARTICIPANTS

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

**Kerry Shiba** *Wesco Aircraft Holdings, Inc. - Executive VP, CFO & Interim Principal Accounting Officer*

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

### CONFERENCE CALL PARTICIPANTS

**Caitlin Dullanty** *BofA Merrill Lynch, Research Division - Research Analyst*

**Christopher David Olin** *Longbow Research LLC - Analyst*

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

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

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

### PRESENTATION

#### Operator

Good day, ladies and gentlemen, and welcome to the Wesco Aircraft Holdings Third Quarter Fiscal Year 2018 Earnings Call. (Operator Instructions) As a reminder, this conference is being recorded. I would now like to introduce your host for today's conference, Jeff Misakian, Vice President, Investor Relations. Sir, you may begin.

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

Thank you, Imani. Good afternoon, everyone. Thank you for participating in Wesco Aircraft's Fiscal 2018 Third 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](http://www.wescoair.com) and clicking on Investor Relations.

We're joined today by Todd Renehan, Chief Executive Officer, and Kerry Shiba, Executive Vice President and Chief Financial Officer. Alex Murray, President and Chief Operating Officer, also is 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 will turn the call over to Todd Renehan. Todd?

#### Todd Renehan - Wesco Aircraft Holdings, Inc. - CEO & Director

Thank you, Jeff. Please turn to Slide 3. Results for the fiscal 2018 third quarter continue to demonstrate that we're returning to solid operational and financial performance. They reflect strong sales growth and gross profit improvement, partially offset by higher consulting fees and costs associated with Wesco 2020. Our top-line performance was driven by growth in long-term contracts, strong ad-hoc sales and one-time sales



## AUGUST 02, 2018 / 9:00PM, WAIR - Q3 2018 Wesco Aircraft Holdings Inc Earnings Call

associated with certain contract claims. At the same time, we continued to manage expenses tightly while investing in Wesco 2020 for the long term.

These improvements contributed to a substantial increase in net income and adjusted EBITDA margin expansion in the third quarter compared with the same period last year. We also reported positive operating and free cash flow for the first time this year, reflecting profitability improvement and reduction in inventory investment in the third quarter, even with the sales growth we achieved.

From an operational perspective, metrics improved as we continued to drive change in the business and stepped up the execution of Wesco 2020 initiatives. I'll talk more about Wesco 2020 in a few minutes after I provide you with an update on the business.

Please turn to Slide 4. Top-line growth was strong in the fiscal 2018 third quarter compared to the same period last year. We benefited from \$11 million of one-time sales related to contract claims, but even excluding these sales, our underlying growth was 10%. Sales reflect our continued strong position in robust aerospace market conditions and greater demand for supply chain services.

Ad-hoc sales increased at a double-digit pace as a result of our improved service and higher orders from key customers. Long-term contracts increased at a faster rate in the third quarter, reflecting new business revenue and higher volumes on existing contracts, particularly in chemicals. At the same time, ad-hoc bookings were stronger in the quarter compared to both the same period last year and the previous quarter.

We maintained tight control of expenses in the third quarter. Expenses were up primarily because of costs associated with Wesco 2020, including consulting fees and other costs that we view as good long-term investments, given the return we expect with Wesco 2020. SG&A as a percent of sales was virtually flat compared to the same period last year.

We managed our inventory investment at a much better pace in the third quarter, even with our sales growth, as we continued to work on processes related to inventory management. We're making progress improving our ability to forecast sales demand and developing more accurate decision-making tools. Our SIOP process continued to mature, but we have a lot more work to do. To make greater inroads in driving change, we reallocated consultant resources to assist us with developing better SIOP processes.

Customer service performance continues to improve. Weekly fill rates at major sites are increasing, and delivery quality metrics are improving. We maintained overall on-time delivery rates at high levels. Overall, we made good progress improving our business performance in the third quarter.

Please turn to Slide 5. We have significantly increased the pace of execution of Wesco 2020 in the quarter. We're engaged in activities supporting multiple initiatives across the company. We've made good progress and accomplished a lot so far. For example, we've taken steps toward facility consolidation and are starting to transfer inventory. We're investing in multi-commodity hubs, building out and staffing existing sites, and identifying new operating consolidation sites with much of the resource planning largely completed. We've implemented a project management structure with multiple work streams, dedicated teams and a regular cadence of reporting to increase accountability. We established global centers of excellence and are investing in critical capabilities. We also made several organizational changes to improve our processes, eliminate duplication and reduce costs, and planning's underway to increase our use of automation and business tools, with field testing of some applications already started.

As we mentioned last quarter, some of our initiatives must roll out in sequence, so the timing of upstream actions will affect the downstream capture of benefits. We're also prioritizing demands on our people's time, carefully deploying resources to keep our customers' needs paramount while we execute projects designed for long-term benefits. Mindful of these priorities, we've refocused the work of consultants to help drive an aggressive pace and provide additional expertise. We still have a lot of work to do, but we remain on track with our previously communicated time line and financial goals.

Now I'll turn the call over to Kerry to review our third quarter financial results. Kerry?



## AUGUST 02, 2018 / 9:00PM, WAIR - Q3 2018 Wesco Aircraft Holdings Inc Earnings Call

**Kerry Shiba** - Wesco Aircraft Holdings, Inc. - Executive VP, CFO & Interim Principal Accounting Officer

Thank you, Todd. If you'd now please turn to Slide #6. Net sales of \$410 million increased 13% in the fiscal 2018 third quarter compared with the same period last year. Excluding one-time sales of [\$1 million] related to contract claims, underlying sales increased 10%. The rest of my sales discussion will exclude the benefit of these one-time sales from the period-to-period comparisons.

Sales under long-term contracts increased 7%, driven by new business revenue and high volumes on existing contracts. Revenue growth was robust for chemical products and services, rising in the high-single-digit percentage range, while hardware product sales increased in the mid-single-digit percentage range. Stronger demand for our products was particularly evident in the military sector, and we also saw increased demand for new business jet models. Ad-hoc sales were up 18% and reflected our ability to service a broad-based increase in non-contract orders for hardware products.

The improved revenue trends for the current year also are reflected in a sequential basis, as sales increased 2% excluding the one-time sales, primarily due to growth in chemicals and ad-hoc sales.

Please turn to Slide 7. Income from operations in the third quarter increased significantly when compared to the same period last year. While this comparison reflects a large goodwill impairment charge recorded in last year's third quarter, the remainder of the year-over-year change shows substantial sales-driven improvement in gross profit, partially offset by an increase in SG&A expenses. Operating income was \$4 million lower sequentially due to lower gross profit and higher SG&A expenses.

Looking at a bit more detail, gross profit was \$14 million higher year-over-year, primarily due to sales volume growth and a 60-basis-point increase in gross margin. Gross margin expansion reflects higher ad-hoc and hardware contract margins and a favorable sales mix. These increases were partially offset by lower chemical margins resulting from contract transitions and higher pass-through revenue, which arithmetically dilutes margin percentage.

Gross margin declined 170 basis points sequentially, primarily due to a higher provision for excess and obsolete inventory and inventory adjustments. Excluding inventory-related adjustments, gross margins were higher sequentially for ad hoc and contract hardware products as well as chemical contracts. We also benefited from a favorable sales mix compared to the previous quarter.

SG&A expenses in the fiscal 2018 third quarter were \$9 million higher than in the same period last year, as our Wesco 2020 improvement initiative drove \$6 million of higher consulting fees and \$1 million of retention and stock-based compensation implemented as part of our change management process. We also incurred higher staffing costs necessary to prepare growing facility consolidation sites for execution of related Wesco 2020 footprint optimization moves.

Sequentially, SG&A was \$2 million higher, primarily due to Wesco 2020 consulting costs. As Todd mentioned, our focus has moved into project execution, and the increased work of consultants reflects the heightened activity associated with this phase. We also increased focus in certain areas, a key example being our process spanning from sales forecasting through inventory procurement and management.

Interest expense in the third quarter increased \$3 million year-over-year, mostly as a result of higher LIBOR rates. Our effective tax rate was 36% in the fiscal 2018 third quarter. Excluding the impact of discrete items, the year-to-date run rate and outlook for the year have increased roughly 100 basis points, primarily due to a continued shift in earnings mix towards higher tax rate jurisdictions. As a result, our run rate outlook for the fiscal 2018 full year currently looks like a range of 29% to 30%.

Discrete items have had a noticeable impact on the all-in effective rate, equal to roughly 370 basis points in Q3 of this year and almost 20 percentage points year-to-date. The discrete item having by far the largest single impact in fiscal 2018 is the \$9 million transition tax resulting from the change in U.S. tax law and was recorded in Q1 of this year.

We reported earnings per share of \$0.11 in the fiscal 2018 third quarter compared with a loss of \$2.32 in the same period last year. Adjusted earnings per share was \$0.20 compared with \$0.10 in last year's third quarter. Adjusted EBITDA increased \$12 million or 35% year-over-year, primarily due

## AUGUST 02, 2018 / 9:00PM, WAIR - Q3 2018 Wesco Aircraft Holdings Inc Earnings Call

to higher gross profit, partially offset by the increase in SG&A. Adjusted EBITDA margin increased 170 basis points when compared to the third quarter last year.

Please now turn to Slide #8. Accounts receivable increased \$15 million in the third quarter, primarily due to the higher sales. The increase in net inventory was \$4 million, reflecting a reduced investment despite the significant sales growth. As Todd noted, this increase was at a substantially lower rate than in the first two quarters of the fiscal year and when compared to the increases in fiscal 2017. Net debt decreased \$13 million in the third quarter, primarily reflecting a \$10 million increase in cash and \$5 million in term loan repayments we made during the quarter.

Please now turn to Slide #9. Cash provided by operating activities was \$17 million in the fiscal 2018 third quarter, \$16 million better than the \$1 million in last year's third quarter and \$23 million better than the \$6 million of cash used in operating activities last quarter. The largest single improvement when compared to both last year and the prior quarter is reduced inventory investment. As usual, there are other pluses and minuses that occurred on the balance sheet that I won't attempt to cover line by line.

Free cash flow was \$16 million in the third quarter compared with negative free cash flow of \$2 million in the same period last year and negative free cash flow of \$8 million last quarter.

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

---

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

Thank you, Kerry. Please turn to Slide 10. While I remain pleased with our progress to-date and the hard work of our people, we're not taking our foot off the gas. We continue to execute across the business, leading to another quarter of good operating and financial performance. While our strong top-line growth benefited from some one-time sales and a robust market, it's more a testimony to our sales teams, continued service improvements and our customers' faith in Wesco as a valued supply chain partner. This was clearly evident in the new business revenue, increased existing business volume and higher ad-hoc ordering that we saw in the third quarter.

We also made progress improving our product margins in the third quarter, and we maintained tight control over expenses. From an operational perspective, we made continued progress in service performance and inventory management, which led to improved metrics and substantially less inventory investment in the quarter. These factors contributed to improvement in net income and adjusted EBITDA relative to the same period last year as well as positive operating and free cash flow.

This is all good news, but as we said in the past, these results remain well below our potential. We'll continue pushing hard to improve our business performance while we execute Wesco 2020 initiatives to create greater value for our shareholders in the long term. We've increased the pace of execution on Wesco 2020 initiatives and made good progress in the quarter. We're on track with our previously communicated goals, but we still have a lot more work to do. We'll provide another update on our Wesco 2020 progress on our fourth quarter earnings call.

Now I'll turn the call back over to Jeff to direct the Q&A session.

---

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

Thank you, Todd. We'll now open the call for the Q&A period. Imani, may we have the first question, please?

## QUESTIONS AND ANSWERS

### Operator

[Operator Instructions.] Our first question comes from Michael Ciarmoli with SunTrust.



## AUGUST 02, 2018 / 9:00PM, WAIR - Q3 2018 Wesco Aircraft Holdings Inc Earnings Call

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

Maybe, Todd, just on the 2020 outlook, can you guys potentially give us a little bit more color in terms of how you might be thinking about the business on longer term from either the right metrics we should look at in terms of gross margins, SG&A or even sort of any kind of longer-term target margins that you could basically share with us that you might be thinking of how we should look at the long-term profitability of the business?

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

We get a lot of questions about the core EBITDA potential for the business and when we're going to see it. And I would frame it this way, like we've done in the past. One is we're improving the business in 2018 and we expect to exceed our previous outlook for the fiscal year. We are going to have even better performance with Wesco 2020, and we're confident of the targets that we set out for Wesco 2020: a \$30 million improvement in run rate towards the end of '19. We're in the process now of developing our financial plan for 2019, and we'll decide what to say about that at a later time. So we're really not in a position to share specific targets other than maybe some of that guidance that I just tried to give.

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

Maybe, then, just totally shifting gears, ad-hoc sales up 18%. Can you guys point to any -- I mean there's obviously a lot of supply chain constraint out there. It seems like some lead times are stretching out. But then you've also got the KLX noise, being acquired by Boeing. Has that created any disruption in the marketplace? Maybe can you just kind of quantify if you're seeing any benefits tied to either supply chain constraints or just general market disruption related to KLX?

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

Sure, of course. Our customers have increased ordering for a lot of different reasons. We're definitely seeing an increase in demand. Some of it is the result of our improved execution, which is helping us grab back share. We definitely have some tailwinds from the robust market and as I said, the customers are seeing a pickup in their operations, particularly for us in the military and the business jet. But really, all sectors are picking up. Lead times are around the 30-week range, and that's helping us at the same time. So I think all of those things combined are adding to the wind in the sails.

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

Anything you could point to with disruption, maybe customers moving away from KLX or just uncertainty over there?

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

Our opinions on that acquisition haven't changed, and I would just say they continue to be supported by customers and suppliers in our conversations. So for all the same reasons that we stated before, we think that could potentially be an upside for us.

**Operator**

And our next question comes from Ronald Epstein with Bank of America.

**Caitlin Dullanty** - BofA Merrill Lynch, Research Division - Research Analyst

It's Caitlin on for Ron today. Firstly, can you guys just talk about what caused gross margin to decline in the quarter on a sequential basis?

## AUGUST 02, 2018 / 9:00PM, WAIR - Q3 2018 Wesco Aircraft Holdings Inc Earnings Call

**Kerry Shiba** - *Wesco Aircraft Holdings, Inc. - Executive VP, CFO & Interim Principal Accounting Officer*

On a sequential basis, it really was the inventory-related charges, adjustments which occur typically every quarter based on physical quantity and then there's the E&O adjustment that we booked in the quarter that was higher than in the prior quarter. So if you strip that away, I think the margins were relatively neutral, up a little bit, not to the extent of the year-over-year comparison, but still up a bit. So there were these noncash items.

**Caitlin Dullanty** - *BofA Merrill Lynch, Research Division - Research Analyst*

And then talking about the consulting fee, can you guys give us a sense if we should think about this as the run rate for the consulting fee each quarter going forward? And then when should we expect that expense to roll off?

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

Right. I'll start that if Kerry wants to add to it. We do a resource plan every quarter - Kerry, Alex and myself -- with the consultants that we're using, and more often if needed. And we constantly balance the need to push the pace and the need for project management with specific needs we might have also to strengthen positions, like in our SIOP or in our procurement. So we look at that every single quarter. We anticipate that the expenses will start to decline over Q4; if not Q4, into Q1. So we'll start to see that coming down as we shift from all the analysis mode into project management and helping us push the pace of the projects.

**Kerry Shiba** - *Wesco Aircraft Holdings, Inc. - Executive VP, CFO & Interim Principal Accounting Officer*

I'll just add -- I think Todd had mentioned this earlier -- that there are variables there. We've been very, very busy as far as sales volume has been concerned. Of course, our customers are always going to be put first, and as that takes resources from the business and we want to keep pushing the 2020 initiatives with regard to pace, we will supplement as appropriate our ability to manage all the programs. So there are some variables that will cause us to continue to reevaluate. As Todd mentioned, we really look at this every month as far as what the assistant staffing plan is.

**Operator**

And our next question comes from Gautam Khanna with Cowen and Company.

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

I was hoping you could comment on what the aftermarket sales were as a percentage of revenue and any of the initiatives that you've undertaken recently to bolster that business, if any.

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

The aftermarket percentage is pretty consistent with what it's been all year, which is about 6%. We continue to have a specific group focused on the aftermarket. We've taken some of those initiatives under our Chief Commercial Officer, where we added some of those capabilities. And we continue to focus on both the marketing, the prospect development, lead generation, and execution inside of Wesco to make sure that we can meet the specific needs of that aftermarket category.



## AUGUST 02, 2018 / 9:00PM, WAIR - Q3 2018 Wesco Aircraft Holdings Inc Earnings Call

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

Okay, and maybe could you comment broadly on the pricing environment in the ad-hoc market, and both on the OE side and in the aftermarket? Are you actually seeing opportunities to increase price in this environment, or are there still kind of the macro pressures pervading?

**Kerry Shiba** - Wesco Aircraft Holdings, Inc. - Executive VP, CFO & Interim Principal Accounting Officer

It's a little bit of both. People make decisions for a lot of different reasons. The market has always been competitive. We continue to compete, deal by deal, in both ad hoc and long-term agreements and JIT contracts. And that really hasn't changed. Where we have the opportunity to up price because we have a significant differentiator or a tremendous value, then we do. It's not a tremendously common thing, but we take advantage of it where we can.

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

And last one for me. Could you characterize the re-compete environment as you look into the next 12 to 18 months? How much of your business, your contracted business, is up for rebid, and how does that compare with maybe the last 12 to 18 months? And any large, large, lumpy customers, if you will, that are up for rebid. Thank you.

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

Honestly, we would never really disclose what's up for renewal in any particular year. The way I would maybe give you some color is on average, our long-term contracts are 3 to 5 years in duration. Some years are heavier than other years, and we are exiting some of the heavier years and entering some of the lighter years.

**Kerry Shiba** - Wesco Aircraft Holdings, Inc. - Executive VP, CFO & Interim Principal Accounting Officer

As far as renewals, right?

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

As far as renewals, contracts coming up for renewal.

**Operator**

[Operator Instructions.] Our next question comes from Jon Raviv with Citi.

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

Todd and Kerry, I'll try Mike's question in a different -- a slightly different way. Of this \$30 million target that you have for the Wesco 2020 plan, can you give us a sense almost off of what base or what run rate you expect to make that improvement? For example, take the FY18 results and add \$30 million to that? Just some -- just seeing if there's a way to think about it that way.

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

Yes, no, that's a good question. Our benchmark for Wesco 2020 was the end of fiscal year 2017.



## AUGUST 02, 2018 / 9:00PM, WAIR - Q3 2018 Wesco Aircraft Holdings Inc Earnings Call

**Kerry Shiba** - *Wesco Aircraft Holdings, Inc. - Executive VP, CFO & Interim Principal Accounting Officer*

And again, it was run rate, exit run rate that we saw, fundamentally fourth quarter earnings rate in 2017, and then projected off of that as being the base.

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

Okay, so just to confirm the fiscal fourth quarter '17 number, not the full year number?

**Kerry Shiba** - *Wesco Aircraft Holdings, Inc. - Executive VP, CFO & Interim Principal Accounting Officer*

Primarily that, yes.

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

On the -- in terms of the overall landscape, your competitor disclosed what they described as a takeaway win during the quarter. You guys had a big win in the quarter. I imagine there's always competitive wins and losses in each direction. Any thoughts on your ability to sustain the impressive growth rates that we've seen thus far, fiscal year to date?

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

We continue to have the thoughts that we're going to grow above the market rate. We have a very high retention rate, and we told you that we just came through two big years of contracts up for renewal, and there are going to be less going forward. The ad-hoc growth was really strong in the third quarter. Seasonally, the third quarter historically is our best quarter, both for bookings and for sales. And the fourth quarter is typically the slowest historically. So we still expect to grow in ad hoc, but honestly, I don't expect to be at that Q3 pace, which was almost 20%.

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

On the ad hoc specifically.

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

On the ad hoc, right, right.

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

And then on the, just on the E&O charge, the inventory charge, and I know you do that some type of test that you take every quarter, but it's not a -- just kind of more what drove that charge or whether -- it seems somewhat material for you to call out, at least. Is it typically that there's a charge, or is there some kind of cleaning up going on here as you implement and get the consultants kind of inside the building?

**Kerry Shiba** - *Wesco Aircraft Holdings, Inc. - Executive VP, CFO & Interim Principal Accounting Officer*

Yes, I wouldn't characterize the charge as being the result of any unusual cleanup. We do test this every quarter. I think I mentioned this last quarter. We've got over 500,000 parts in inventory. We develop a demand, a sales forecast, literally at the part number level, compare that to what we have, and we make a reserve adjustment when our inventory level exceeds what we project out as a future demand for a specific period of years. So it's



## AUGUST 02, 2018 / 9:00PM, WAIR - Q3 2018 Wesco Aircraft Holdings Inc Earnings Call

a lot of detail that we grind through. Do I expect that the nature of the business will lead us to additional charges going forward? The answer is yes, the magnitude of which, though, is going to vary, quarter-by-quarter. The nature of the business is you buy long to try to best balance the economics of price breaks from our suppliers, to be competitive in our marketplace in which we sell into, and that oftentimes is going to leave a tail of inventory out there. And so as time goes on, that tail gets revalued.

---

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

Are some of the efforts and improvements that you're making around Wesco 2020 meant to blunt the charges that you might take on a quarterly basis? And sort of on a related note, do you ever take positive charges when things get better than you expected?

---

**Kerry Shiba** - Wesco Aircraft Holdings, Inc. - Executive VP, CFO & Interim Principal Accounting Officer

I'm sorry. You cut out a little bit. I missed, I think, the first part of your question as to whether or not we take positive charges or -- the answer is no. Once written down, it's -- inventory's written down and it's kept there. For GAAP reasons, we can't write anything back up.

---

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

And the first part of the question, let me take a shot on, is we've -- it's been now a year since we started our kind of initial four focus areas. One of those areas was improvement in the way we handle procurement and improve the way we purchase. So there's been a lot of tightening up of the process to slow the inflow of inventory where historically we might have purchased too early and too long.

The other thing is we have the development of a lot of tools to improve our decision-making around buying and holding. And those will eliminate, I think, the future buildup of this inventory group.

---

**Operator**

And our next question comes from Christopher Olin of Longbow Research.

---

**Christopher David Olin** - Longbow Research LLC - Analyst

I get this, after talking to some of the competitors out there, that producer lead times are getting extended, which you did refer to, and now you're hearing about supplier reliability. I guess I'm wondering, when you look at your planning, is there any risk that on-time shipments at the mill level could disrupt your visibility or your flow of revenue?

---

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

We watch that very carefully. We have very good relationships with our suppliers. We've got a main group of suppliers and we're constantly talking about ways to share information, communicate better to improve overall on-time delivery rates where we ultimately have to get it to the customer on time. So we're not anticipating any disruption or deterioration from supplier-manufacturer delivery.

---

**Christopher David Olin** - Longbow Research LLC - Analyst

Okay. At any point during this past quarter, were you forced to, say, source some material from a smaller independent player, maybe to keep up with that ad-hoc streams that you referred to, that up 18%? I'm just wondering if the margins were less interesting this quarter just because of inventory holds or what you want to call it.



## AUGUST 02, 2018 / 9:00PM, WAIR - Q3 2018 Wesco Aircraft Holdings Inc Earnings Call

---

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

Yes. I look -- two ways to answer that. One is we always buy from each other, and two, it's at a very small rate, and for us it's been very consistent over the past several years. A very small percentage of our buy comes from other distributors, but when we get in a jam, we buy from them and they buy from us.

---

**Christopher David Olin** - *Longbow Research LLC - Analyst*

Okay, but you weren't in a jam this past quarter?

---

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

No more than normal. Very consistent amount of purchases from our competitors.

---

**Operator**

And we do have a follow-up question from Gautam Khanna, Cowen and Company.

---

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

I was curious to how you're incentivizing the sales staff. Are they incentivized on gross margin? Are they just trying to rebuild customer relationships and get unit volume up? Sort of how have you evolved those metrics as you've embarked on kind of the rebuild?

---

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

Right now the incentive is the same, which is a base compensation and a bonus for employees. Whether you're an employee or a manager, you're part of an incentive plan, and that's based on company performance on EBITDA and on cash. We are, though, working very diligently to quickly put in a variable compensation program for our sales folks, which will be driven on revenue and margin. But we still have work to do to execute that.

---

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

Okay, and what about aligning -- any sort of alignment with cash, with inventory, or no?

---

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

For -- is that a sales comp question, aligns to cash?

---

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

All in, yes. Senior management, actually.

---



## AUGUST 02, 2018 / 9:00PM, WAIR - Q3 2018 Wesco Aircraft Holdings Inc Earnings Call

**Kerry Shiba** - *Wesco Aircraft Holdings, Inc. - Executive VP, CFO & Interim Principal Accounting Officer*

Oh, yes, yes, of course. Yes. Our incentive compensation for senior management has a very big percentage of cash. So it's a strong percentage of EBITDA versus plan, it's a strong percentage of cash versus plan, equal to EBITDA, and then a very small percentage on individual performance.

**Kerry Shiba** - *Wesco Aircraft Holdings, Inc. - Executive VP, CFO & Interim Principal Accounting Officer*

And the long-term plan, the equity-driven plan, is fundamentally return on invested capital. So of course, inventory, being the largest single asset in the company, is a big component of that.

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

And one last one. Any opportunities to partner with Boeing and KLXI as opposed to view them as a threat and just a direct competitor? Are there any ways to -- that you guys have thought through to potentially work with them as opposed to against them so that it's a potential win-win? I can't think of it, but maybe I'm not thinking about it holistically.

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

I would just maybe say that we supply both of them a lot of product and Boeing a lot of product and service today on hardware and chemical and electronics as well as supply chain services. And we supply KLX product today, and we supply, where KLX has certain lead positions, we act as one of their providers and suppliers. So there is a somewhat competi-mate relationship going on right now. But more than that, there's really not.

**Kerry Shiba** - *Wesco Aircraft Holdings, Inc. - Executive VP, CFO & Interim Principal Accounting Officer*

That's kind of in the normal ebb and flow of the business going on day-to-day in the industry. Yes, that's a normal dynamic, and we've mentioned before our concentration overall with Boeing is not significant to the degree that we feel a significant risk from the acquisition. So yes, I mean, it's kind of normal ebb and flow. Have there been any major thoughts about a different strategic prong based on this? The answer is no.

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

And I said that was my last one, but another one, if I may. The exposure to BASN -- at this point, do you think the flush has already happened with respect to folks who could transition that were customers of yours that have done so, or is there some incremental risk as we move forward? And relatedly, again, I've asked this in the past, but KLXI has talked about contract wins, market share gains. Is there any sort of looming reset on the revenue base that we're going to see as we move out on contracts that maybe you didn't retain when they were up for renewal?

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

I think we're well beyond the worst part of BASN, and we continue to compete and win against BASN. And in terms of the reset from a market share standpoint, not anticipating any of that. We continue to grow, as you can see from the past several quarters. We continue to compete and win. We continue to have a high renewal rate. And we're in a strong market position with a very strong value proposition.

**Operator**

And we do have a follow-up question from Jon Raviv with Citi.



## AUGUST 02, 2018 / 9:00PM, WAIR - Q3 2018 Wesco Aircraft Holdings Inc Earnings Call

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

Todd, you called out military, you called out biz jet as being strong cores. Is there something special going on there, or is it just coming off of a lower base, and therefore comes through more noticeably?

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

I think there's been some good demand for our biz jet customers and a little bit of a turnaround in their business -- their volumes picking up. On the military side, we have military and defense, we have strong concentrations with some big players, and they're very active with some of those military platforms, both in fighter jets and missile programs, and it's been very good for us.

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

And on the military side, we know that one platform you do have exposure on is the F-35. F-35 is ramping up, but F-35 is also under some cost pressures from the customer, as is always the case. Where do you think Wesco fits into that? Are you involved in discussions in terms of helping make things more efficient and help with those cost goals?

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

Always, always. Absolutely. It's a regular and ongoing discussion with myself included in most of those discussions, to constantly try to figure out ways to make that platform more efficient and more cost effective.

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

Okay, and then you also mentioned that you reallocated some consultant resources in the quarter. Can you just expand a little bit upon what drove that and whether it's because they finished some things early or you need to accelerate other things? Just kind of what did they reallocate away from into?

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

Got it. Yes, when you start out a project like that, it's all about uncover every rock and pull every thread. And you typically have higher-paid consultants doing that kind of work. And then you shift into project management mode, where you've got the targets, you've got the initiatives, you've got the teams set up. And then you need just more kind of brute force to help you push the pace and to manage the project. So that's one change that just naturally happens.

And to Kerry's point earlier, we're always considerate of our own people's time. When you have a project like this, you have a group of people who are doing a great job for the company, and they're already taking care of the P&L and taking care of the customer and driving cash. And they're the same good people that you go task to do a Wesco 20 set of initiatives -- 2020. So we have to be careful of their capability and not to lose focus on the people, the customers and the profit of the company. That's another reason that you bring in, then shift consultants.

And then the third reason, I would say, is we've been doing a lot of work, but we've continued to need additional expertise on our sales, inventory, operations planning and overall change management. So those are some of the shifts that we made.

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

Okay, and then just, Kerry, a last one for you. Any updated thoughts and goals around deleveraging and where you want to get to and when?



## AUGUST 02, 2018 / 9:00PM, WAIR - Q3 2018 Wesco Aircraft Holdings Inc Earnings Call

**Kerry Shiba** - *Wesco Aircraft Holdings, Inc. - Executive VP, CFO & Interim Principal Accounting Officer*

Well, the -- obviously, we start with the cash flow generation being the root of it. I'm pleased, quite honestly, where we ended up in the third quarter, a combination of two things: continued growth in revenues driving growth in earnings. Some of the revenue growth, of course, gets hung up on the balance sheet and gets collected the next quarter.

The big variable was the better control of inventory, getting better leverage on specifically the hardware inventory. So deleveraging with respect to the cash flow we generate will continue to be a priority. So my view, there will be -- and some investments required in the business, but this is not a fixed, capital-intensive business at all. We'll invest some money over the Wesco 2020 program as we realign our distribution footprint, but I think that will pay back very quickly. We've talked about some systems work. That will be some investment, but I think it will be well worth it. But in the grand scheme of things, those aren't big cash things for the business overall. So getting better control of the inventory asset is key #1, and then what cash we generate, paying down debt clearly is a top priority.

**Operator**

This concludes today's Q&A session. I would now like to turn the call back over to Jeff Misakian for closing remarks.

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

Okay, thanks very much. On behalf of everyone here 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. Thanks and have a good evening.

**Operator**

Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program. You may all disconnect. Everyone have a great day.

**DISCLAIMER**

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2018, Thomson Reuters. All Rights Reserved.