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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Wesco Aircraft Holdings Fourth Quarter and Fiscal Year 2018 Earnings Call. (Operator Instructions) As a reminder, this call is being recorded.

I would now like to turn the conference over to our host for today, Jeff Misakian, Vice President of Investor Relations. You may begin.

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

Thank you, Sonya. Good afternoon, everyone. Thank you for participating in Wesco Aircraft's Fiscal 2018 Fourth 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, 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'll turn the call over to Todd Renehan. Todd?

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

Thank you, Jeff. Please turn to Slide 3. We finished fiscal 2018 with another quarter of strong sales growth, while we continue to invest in our future. Throughout fiscal 2018, we've been able to capture more opportunities in a growing market because of the improvements made earlier in the year. Our performance is a testimony to the hard work of our Wesco team and our customers' continued recognition of the value proposition we offer.

Higher sales volumes in the fourth quarter helped drive profit improvement relative to the same period last year. We also controlled ongoing expenses relative to our sales growth and continue to invest in Wesco 2020 for the long term. In addition, cash from operations and free cash flow improved in the fourth quarter, resulting in positive cash flow for the full year. We also made further improvements in operating metrics as we continue to drive change throughout the organization.

As I said in the past, while our better performance in fiscal 2018 is important, these results are far from our full potential. We continue to address performance gaps in the business through Wesco 2020, which, we believe, will drive long-term improvement. We deepened our execution of Wesco 2020 initiatives in the fourth quarter and expect to accelerate this further in fiscal 2019.

Please turn to Slide 4. Top line performance in the fourth quarter continued to benefit from a strong market as well as greater demand for supply chain services. Although sales benefited from one-time items of $6 million in the quarter, we delivered solid underlying growth of 11%. Ad hoc sales increased at a double-digit pace as we captured high orders from our key customers. Sales under long-term contracts grew better than mid-single digits in the quarter, reflecting new business and higher volumes on existing contracts for both chemical and hardware products and services. The current environment continues to support these favorable trends with robust ad hoc bookings and a solid pipeline of new business opportunities.

We continued to exercise expense discipline in the fourth quarter. SG&A expenses were higher primarily because of consulting fees and other costs related to our Wesco 2020 initiative. SG&A expenses as a percent of sales would have been approximately 160 basis points lower excluding these Wesco 2020 related costs. While we continue to view consulting costs as an important investment, they declined sequentially as we begin to move deeper into program execution. We expect these consulting costs to decline further in fiscal 2019.

We know that we're carrying a high expense base going into fiscal 2019, primarily due to Wesco 2020 implementation, investments in certain areas to upgrade our capabilities and cost to support our growth. We continue to expect Wesco 2020 to drive cost out of the business, but it's important to keep in mind that fiscal 2019 also will be a heavy investment year for us as we deepen our execution of Wesco 2020 initiatives. I'll talk more about Wesco 2020 in a moment.

We made significant progress managing inventory in the quarter, tightening our processes from demand forecasting through procurement and utilizing our enhanced business tools more effectively. As a result, inventory declined slightly in the fourth quarter, despite continuing to support our customers and the increased demand for our products, helping to drive the increase in operating and free cash flow that I mentioned earlier. We'll continue to work on making our inventory processes more efficient in fiscal 2019 through our Wesco 2020 initiatives.

Please turn to Slide 5. We made further progress with the implementation of our Wesco 2020 alignment initiative in the fourth quarter. Last quarter, we told you that we're making preparations for the transfer of inventory to be closer to our customers. The transfer process is now underway, although the largest changes are yet to come. We also furthered the execution of our footprint optimization plan, consolidating smaller facilities into larger distribution hubs. We continue to invest in and expand existing distribution centers to facilitate the inventory transfers, while securing new locations to serve as future sites.

In our refinement initiative, we further streamlined our organizational structure in the fourth quarter and reduced administrative functions, while implementing new processes in SIOP, procurement and pricing. We've continued to invest in key capabilities, particularly in our global centers of excellence, to establish best practices and deliver more consistent performance. We also made changes to our organizational design, which are now resulting in faster decision-making, improved customer service and reduced operating expenses. Among our investment initiatives, we recently selected a new warehouse management system, which will deploy over the course of the year across our global sites. This new system will enable us to further optimize processes; improve labor utilization, delivery performance and customer service; reduce cycle time; and deliver significant cost savings.

We also continued to upgrade business tools to improve our inventory management processes, including demand forecasting through procurement decisions. We expect to continue to further refine our capabilities in this area in fiscal 2019.

Wesco 2020 remains on track to generate significant long-term benefits to our business. We've already seen improvements in revenue growth and cash flow performance in fiscal 2018, along with investments we've been making for the long-term health of the business. As I said earlier, fiscal 2019 will continue to be a heavy investment year as we transition products through our network and invest in our systems, processes and people. We expect to see full realization of the operating benefit of Wesco 2020 in fiscal 2020.

Now I'll turn the call over to Kerry to discuss our fourth quarter results. After which, I'll provide closing comments and discuss our fiscal 2019 outlook. Kerry?

Kerry Shiba ***Wesco Aircraft Holdings, Inc. - Executive VP & CFO***

Thank you, Todd. Excuse me. I'm going to start on Slide #6, please. Net sales of $407 million increased approximately 13% in the fiscal 2018 fourth quarter when compared with the same period last year. Excluding one-time sales of $6 million related to contract claims, underlying sales increased 11%. The rest of my sales discussion will exclude the benefit of these one-time sales from the period-to-period comparisons.

Contract sales increased 7%, with solid growth throughout the major areas of our business. Chemical products and services grew 10% in the quarter, particularly in pass-through revenue as we benefited from our position in the military sector and the ramp-up of the Joint Strike Fighter program. Hardware products increased at a 4% pace, primarily due to higher business jet and military demand.

Ad hoc sales increased 22% in the quarter, reflecting our improved ability to service broad-based demand in a healthy market as a result of increased inventory availability and faster turnaround times from our sales organization. Sales were stable sequentially, reflecting higher ad hoc and chemical sales that were partially offset by seasonally lower hardware contracts.

Turning now to Slide #7. Income from operation increased $2 million in the fourth quarter compared to the same period last year, reflecting higher gross profit, partially offset by an increase in SG&A. Operating income was $7 million lower sequentially due to a decline in gross profit and higher SG&A.

Looking deeper into operating income details, gross profit increased $11 million year-over-year, primarily reflecting higher sales volumes. Gross margin also increased slightly, reflecting higher hardware margins, partially offset by lower chemical margins. The chemical margin decline primarily reflects a greater mix of pass-through revenue relative to the fee income. Gross margin declined 110 basis points sequentially, primarily due to lower chemical margins, which reflects the same comment I just noted in the year-over-year comparison.

SG&A was $9 million higher year-over-year, primarily due to costs associated with Wesco 2020 implementation that included consulting fees of $5 million and retention-focused compensation costs of $2 million related to the project. In addition, incentive compensation was higher by $3 million year-over-year, reflective of both the stronger financial performance in fiscal 2018 and also an accrual reduction in the fourth quarter of fiscal 2017. SG&A was slightly higher sequentially, with no significant individual line items contributing to the increase.

Interest expense in the fourth quarter increased $2 million year-over-year due to higher interest rates, but interest expense was stable sequentially. Our effective tax rate of 25% in the fourth quarter was lower than the same period last year. The prior year included a previously disclosed noncash income tax charge of $38 million on accumulated foreign earnings.

In fiscal 2018, our effective tax rate was 46%. Discrete items impacted the full year tax rate by nearly 18 percentage points, the largest single item being expense for the $9 million transition tax related to foreign earnings resulting from the U.S. tax law change. The transition tax accrual was recorded in the first quarter of the year.

In fiscal 2019, our effective tax rate is expected to range between 30% and 35%. This range is higher than our previous expectation and reflects clarification regarding certain provisions of U.S. tax law changes that became newly applicable to us in our fiscal year 2019. In fundamental terms, the increase in the effective tax rate outlook is most significantly affected by an unfavorable impact on our ability to apply credits for foreign taxes paid against our U.S. tax liability.

We reported earnings per share of $0.07 in the fiscal 2018 fourth quarter compared with a loss of $0.39 in last year's fourth quarter. Last year's quarterly loss was primarily due to the $38 million noncash income tax charge I just mentioned. Adjusted earnings per diluted share was $0.18 compared with $0.08 in last year's fourth quarter.

Adjusted EBITDA was $37 million in the fiscal 2018 fourth quarter compared with $30 million in the same period last year. Adjusted

EBITDA margin increased by 60 basis points year-over-year in the fourth quarter.

Please turn to Slide #8. Accounts receivable declined $18 million in the fourth quarter when compared to last quarter, reflecting sequentially lower sales volume and collection timing. Inventory was $9 million lower sequentially in the fourth quarter, primarily due to the improvements in inventory management that Todd discussed earlier. Accounts payable declined $12 million in the fourth quarter when compared to last year, mostly due to lower inventory receipts and payment timing around the year-end cut off.

Net debt declined $32 million in the fourth quarter, reflecting repayments on our revolving line of credit and term loans. Cash was essentially stable in the fourth quarter after taking the debt repayments into account.

Turning now to Slide #9. Cash provided by operating activities totaled $37 million in the fourth quarter, $31 million higher than the same period last year and $20 million better than the previous quarter. I just described the largest item affecting the sequential comparison on the previous slide.

The improvement compared to last year's fourth quarter was driven primarily by improved inventory management, offset partially by the net change in accounts receivable and accounts payable in each period.

Free cash flow was $35 million in the fourth quarter, an improvement of $31 million over the same period last year and $19 million better when compared to the previous quarter. Higher free cash flow in the fourth quarter drove positive free cash flow of $12 million for the full fiscal year in 2018, a $48 million improvement compared to the negative free cash flow of $36 million for the full year in fiscal 2017.

With that, I'll now turn the call back to Todd for closing remarks and a discussion of our fiscal 2019 outlook. Todd?

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

Thanks, Kerry. Please turn to Slide 10. Fiscal 2018 was a year of better performance for Wesco. We delivered above-market growth in sales as service improvements made earlier in the year enabled us to benefit from a stronger market and greater demand for supply chain services. At the same time, gross profit increased, and we maintained control over ongoing discretionary expenses not associated with our Wesco 2020 initiatives in fiscal 2018, leading to an increase in adjusted EBITDA of 18% for the full year. We're encouraged by these results, but we still have a lot more work to do.

Wesco 2020 is focused on remaining performance gaps in the business and driving long-term improvement. We anticipate fiscal 2019 to be another year of significant progress and some additional expense as we accelerate the pace of Wesco 2020 execution.

As previously reported, we believe Wesco 2020 will generate annualized pretax benefits of at least $30 million. We anticipate benefit realization in fiscal 2019 to be partially offset by costs associated with implementation, with full realization to be achieved in fiscal 2020.

With this in mind, please turn to Slide 11. We're targeting mid-single-digit percentage growth in net sales in fiscal 2019, driven by new business growth in existing contracts, while our strong customer relationships and inventory position are expected to continue benefiting ad hoc sales, all in a continued healthy market environment. Higher sales volume, Wesco 2020 benefits and expense leverage are expected to drive a high single-digit percentage increase in adjusted EBITDA in fiscal 2019.

Now I'll turn the call back to Jeff to facilitate the Q&A.

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

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Michael Ciarmoli of SunTrust.

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

Todd, may be just specifically to the 2019 outlook, you were just saying that, I was just doing some back of the envelope. I mean, it seems like then EBITDA margins, I think you exited the year here adjusted EBITDA margins, 10.3, I mean, they're only going to be up may be given those ranges of mid-single and high-single digit EBITDA growth, maybe should we expect something like 30 to 50 basis points of improvement next year? Is that the right way to look at it?

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

Yes, I think that's the right way to look at it. That is the right to look at it.

Kerry Shiba ***Wesco Aircraft Holdings, Inc. - Executive VP & CFO***

I think, Mike, overall, our margin expectation is to be relatively stable, relatively flat, maybe just a slight improvement going into next year.

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

Okay. And then can you quantify, I mean, obviously, you had a big chunk you called out the $7 million of expense in the quarter. Can you give us a sense of what the actual expenses are next year? Just to kind of -- so we can sort of may be calibrate and get a better view of what the underlying business might look like?

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

Yes. Let me start that and then Kerry can add to it. First of all, like I said in the comments, the benefits for Wesco 2020 of $30 million run rate is still on track. We are not going to fully realize those benefits all in 2019. We've also got heavy investment year as I talked about. We've got one-time costs and we've got most of the costs that are not recurring. So those will also offset some of the savings in 2019. All of these initiatives lead to benefit in 2020. And we know we're carrying a higher base of SG&A. We do expect SG&A dollars to be flat, but as a percentage of sales, SG&A is expected to decline. We'll have lower consulting fees, but again, with those implementation costs and nonrecurring Wesco 2020 costs, that's taking -- hiding some of the SG&A improvement.

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

Got it. That's helpful. And then just -- last one from me, and then I'll get back in the queue here. But given you kind of highlighted investment numerous amount of times, how should we be thinking about free cash flow or free cash flow conversion next year, impact of the inventory moves? I mean just to kind of calibrate expectations. Any potential color on free cash flow?

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

Kerry?

Kerry Shiba ***Wesco Aircraft Holdings, Inc. - Executive VP & CFO***

Yes, Michael. I think we'll clearly -- I think the improvement we were seeing in the back half of the year, by the time of the year is done, we would expect to see that improvement clearly accelerate, notwithstanding the fact that we'll be making some investments in the business, including, as Todd had mentioned, for the WMS system that we're going to be putting in and some investment in our facilities as we continue on with our footprint consolidation. I'm not going quote you a number on that cash flow expectation. The one thing I do want to make sure you understand now also is that we're going to be through some inventory replenishment cycle, I would expect for the first couple of quarters of the year. So there'll be some choppiness in the year. I think, again, the back half is going to largely be where we see the improvement as the year progresses a little bit of net investment in the first half of the year, driven again by the inventory replenishment. We've been very, very busy, obviously, revenues over the last, last months or in the last year, really. So it's to be expected we hit some replenishment cycle here.

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

Got it. And just one more quick housekeeping, Kerry. The $6 million sort of one-time on revenue, did that come with a much higher margin profile? Or is that in line with current gross margins?

Kerry Shiba ***Wesco Aircraft Holdings, Inc. - Executive VP & CFO***

It's comparable.

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

Yes. It is comparable with the rest of the gross margins, yes.

Operator

And our next question comes from Myles Walton of UBS.

Louis Raffetto ***UBS Research Division - Equity Research Analyst***

It's Louis Raffetto on for Myles. So I just -- I may have missed it, but the EBITDA margins, I mean, it did step down sequentially, and was the weakest of the year. So, was there something else going on underlying -- the underlying business? Or did I miss something? I know there was a lot of adjustments, but that's the adjusted margin so just -- I'm just trying to figure that one out.

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

Yes, I think what Kerry talked about is kind of driven by the sequential decline in gross margins, which really led to the Q4 adjusted EBITDA the way you're seeing it. But keep in mind, there's very little benefit in there from Wesco 2020 and a higher cost base. And again, the full year adjusted EBITDA was 10.3.

Kerry Shiba ***Wesco Aircraft Holdings, Inc. - Executive VP & CFO***

And the other thing that is influenced, this is again, the increase in the chemical revenues were primarily pass-through driven. So -- and the increase was higher than the fee income increase. So just on a higher base of revenue because of the material pass-through you just, arithmetically, get a margin decline.

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***

A couple of questions. First, on ad hoc revenue. If you could just talk about any change in pricing trends there? Are you still seeing pricing power holding strong in that business? Could you differentiate it? Okay. Go ahead...

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

We are. Yes. No, we are. We are definitely seeing it. Strong, strong bookings, strong sales, really good quarter.

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

Okay. The pass-through revenue you cited on the chemical side, is that something that was kind of unusually large in the quarter? Or do we typically have $10 million or so of just straight pass-through?

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

It was relatively stable with past, maybe a little bit higher. At the same time, with the chemical margins, we were in the early months of several startups, which a lot of times there's upfront cost there before the revenue and volume and profit kick in. So between those two things, I think what Kerry said, the majority of it is the pass-through volume drove those declines in the quarter.

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

Okay. And just could you remind us of the relationship between oil or whatever commodity prices that we should be tracking and the pricing mechanisms in the chemical sales? Is there a lag effect or there's something that we should be tracking?

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

No. No, not really. Not really. I mean, there are certain customers that we supply a lot of oil-based products. But that's a small piece of the overall business.

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

Okay. On the guidance, the adjusted EBITDA guidance, just that seems straightforward, below the line, I just wanted to reconcile. So is there anything year-to-year that you can say about. So tax rate, it looks like on an adjusted basis, this year was -- I don't know if this math is right, 38.2% on an adjusted basis? So tax rate is 6% or so positive swing year-to-year. I'm just trying to get to what's the implied adjusted EPS growth rate based on your comments today.

Kerry Shiba ***Wesco Aircraft Holdings, Inc. - Executive VP & CFO***

I think, again, on the tax rate, we had some significant discrete items that hit us this year, I think the underlying kind of run rate effective rate was somewhere in the range of -- if I recall correctly was in the high 20s, about 28%, I believe, when you strip out the big discrete items that hit us during the year.

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

Okay. I'm just trying to get -- so year-to-year, interest expense should be pretty straightforward, tax rate. I'm just curious on a year-to-year, on an adjusted basis, what is the guidance for EPS growth?

Kerry Shiba ***Wesco Aircraft Holdings, Inc. - Executive VP & CFO***

Well, the tax rate expectation next year is that it's going to be somewhere between 30% and 35%. Right now, I think it's pointing towards the lower end of that range. But you can again be choppy depending on discrete adjustments that arise. But somewhere between 30% and 35% for next year.

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

Okay. Last question from me is any change to the competitive environment given the Boeing-KLX transaction? Have you seen any opportunities for market share increase since that deal closed or vice versa?

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

There's been relatively small change in the competitive environment. The competitive environment is always aggressive, has always been aggressive, especially aggressive around big contract renewals. They don't come up that often, and everybody wants them. And there has been ample opportunity for market share gain that we're working on with several customers around the world.

Operator

(Operator Instructions) Our next question comes from Jon Raviv of Citi.

Colin Canfield ***Citigroup Inc, Research Division - Equity Research Associate***

This is Colin Canfield on for Jon Raviv. Could you talk a little bit about your footprint optimization strategy and how you are thinking about consolidating versus securing these sites? And then also how that kind of impacts margin? And what your thoughts are on that?

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

Okay. I will start that, and then Alex, if there's anything you want to add in. We looked pretty extensively with our consulting partner at the best footprint optimization model, and we put those places in parts of the world that would be able to service the customers most effectively. Then we move the product into those major multi-commodity hubs. So the strategy is to have fewer, but larger, more sophisticated, more integrated and technologically advanced multi-commodity hubs. We're in the process now and have been of making some of those changes in terms of consolidating some of the smaller warehouses into those larger sites. And we're, again, 2019 will be the bulk of the work. And at the same time, we're investing and expanding in our existing warehouse distribution centers in terms of further automation, larger facilities and the WMS upgrades that I talked about earlier.

Alex Murray ***Wesco Aircraft Holdings, Inc. - President & COO***

Yes, I think the only thing I would add to what Todd has said, I think he adequately covered the fact that we're consolidating into existing facilities, and we're making investments in existing facilities. We also have some new facilities that will be coming online, but they have not come online yet. So when Todd talks about still a significant amount of work to be done in 2019, a lot of that work is in the standing up of new facilities.

Kerry Shiba ***Wesco Aircraft Holdings, Inc. - Executive VP & CFO***

Still as part of an overall consolidation.

Colin Canfield ***Citigroup Inc, Research Division - Equity Research Associate***

Got it. And just a quick follow-up then, if some of that work is going to trail in to 2020, how should we be thinking about the cadence of margin improvement in 2020? It seems like that if you have a little bit of cost trailing off there, it will be more like a gradual increase towards that run rate of $30 million?

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

It will definitely be a gradual increase of the run rate to $30 million. Some -- a significant amount of that in 2019, but definitely in the first few quarters of 2020.

Operator

You have a follow-up question from Michael Ciarmoli of SunTrust.

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

Todd, I think I heard you mention new processes regarding pricing. Can you just maybe elaborate on that a little bit and whether or not you think that it's going to be accretive to margins as you get whatever process that is implemented?

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

Yes. I would say it's a couple of different angles. One is to automate more of our fast-moving product to make the process of pricing quicker and more responsive to the customer. The other is to consider more of the market to be able to up-price where we can. So we've got specific initiatives working now to put tools in place in the hands of our sales teams around the world with some more guidelines to be able to capitalize on market opportunities and inventory situations whenever we can.

Operator

And we do have another follow-up from Gautam Khanna of Cowen and Company.

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

I was wondering if you could talk about the ad hoc revenue growth. And was this mostly with OEM customers? Or have you seen any penetration gains in the MRO airline market?

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

It is -- the ad hoc growth for the quarter was really in all sectors. It was really a solid quarter in both commercial, in military, specifically with the government, and we have capitalized on the increased ordering and the -- our improved execution in the past has helped us gain share. We're certainly getting some tailwind from the market and tailwind from the customers picking up their operations. And lead time stretching a little bit, 32 to 40 weeks, and we are capitalizing on every bit of it.

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

But can you isolate whether it's to the OEMs and their subcontract manufacturing bases? Or is it ad hoc sales for aftermarket kind of parts usage?

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

It would be more -- it'd lean more towards the OEM and their subcontractors.

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

And what is the mix today if you look back at fiscal '18 of aftermarket sales for the company?

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

It's still relatively small portion of our business, 6%. Approximately 6% of total revenue.

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

And just to get back to your earlier comment on the $10 million-ish of pass-through type of revenue, with ad hoc, I'm just curious, I want to square the point on, ad hoc revenue grew quite fast relative to the overall rate of growth, sales growth that is, yet gross margins went up 10 bps or so. I'm just curious, was that -- how much of that was actually -- was that explained by the pass-through and the new contract startups in your view? Or was it -- I'm just trying to isolate, is the underlying pricing elsewhere deteriorating, maybe not in the ad hoc market, may be in the contracted space or was it mix or something else? I would have expected more margin expansions.

Kerry Shiba ***Wesco Aircraft Holdings, Inc. - Executive VP & CFO***

The impact from the pass-through was on the chemical side. So as we collect our data reported, that would not be impacting ad hoc at all.

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

Right. But overall gross margins, I'm saying, gross margins expanded 10 bps, yet the growth rate of ad hoc was well in excess of the overall growth rate, so I'm just curious, why didn't we see more margin expansion? Or all things, mix is about the same and pricing held in there, it's just that's the way it is. I'm just curious -- or depending on pricing or mix or something else that restrained the rate of margin expansion.

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

No, it really doesn't. The chemical margins in the quarter from Q3 to Q4 really accounted for the majority of the decline. And that -- the primary driver behind that was the increase in pass-through revenue. That was really the main driver of the drop in margins, 3 to 4.

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

And year-over-year? What about year-over-year?

Kerry Shiba ***Wesco Aircraft Holdings, Inc. - Executive VP & CFO***

That would be the same impact. The drop in the percentage margin on chemical was the one area where margins declined, but it was a margin of impact, again, the phenomena of the relationship of the pass-through revenues is that it caused that to occur.

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

Okay. And then just my final one. There was a comment earlier on when you have these big recompeted contracts, contract renewals. They tend to be fiercely pursued. Do you have many -- is there any way you can frame for us the percentage of the business that's up for recompetition in 2019? And how that compares with 2018? We look at normal year.

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

Yes. No, that's a good question. You know our contracts are typically 3 to 5 years. So on average, 20% to 25% of the book of business comes up for renewal. We left 2017 and 2018, were unusually large renewal years, and less so coming at us in 2019.

Operator

And we do have another follow-up question from Jon Raviv of Citi.

Colin Canfield ***Citigroup Inc, Research Division - Equity Research Associate***

Just following up to Gautam's question there on the chemical margins. When we think about the underlying margins there and your guys's ability to negotiate, what kind of milestones should we be tracking for when you guys renegotiate those contracts? Or kind of like the time frame or duration of them?

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

Not sure. I'm completely following the question. Could you try again?

Colin Canfield ***Citigroup Inc, Research Division - Equity Research Associate***

Sorry, so the idea there is that as time goes on, you guys have margin expansion or margin compression opportunities as you renegotiate the chemical contracts. So it's just like when is the next time that you guys negotiate them?

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

Oh, well, the chemical contract business, the chemical business includes contractual business and it includes distribution business, which is more like an ad hoc portion of the business. The majority is contractual. Those contracts are also 3 to 5 years, some much longer. And so they will be renewed 20% to 30% of the entire chemical book of business each year as well. I can tell you, from a chemical side, we have also come out of two very large renewal years and entering into a smaller renewal year. For the amount of contracts that come up for renewal.

Operator

And this does conclude our question-and-answer session. I would now like to turn the call back over to Jeff Misakian for any closing remarks.

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

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

Operator

Ladies and gentlemen, thank you for participating in today's conference. This concludes today's program. You may all disconnect.