



BUILDING AIRPLANE TOILETS ISN'T CUTTING IT ANYMORE FOR ZODIAC AEROSPACE

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Budget airline Ryanair caused an outcry five years ago when it cheekily suggested its airplanes might forgo seats to cut costs, obliging weary passengers to stand instead. In the wake of the troubles at Zodiac Aerospace, a French supplier of aircraft seats, airlines and aircraft manufacturers must be starting to regret the idea didn't catch on.

Zodiac shares plunged 25 percent on Thursday after it issued yet another profit warning because of its inability to deliver seats to customers on time. The struggles raise questions about how well it's been managed, but have broader implications for the industry too.

The company, which also makes aircraft toilets, oxygen systems and emergency slides, no longer expects a 10 percent operating profit margin this fiscal year, compared to 6.4 percent in fiscal 2014/15 (when it suffered late penalty payments, among other things).

Natixis analyst Antoine Boivin-Champeaux counts seven profit warnings in two years, which he told clients was "probably one too many." The latest reflects Zodiac's expectation that its transformation plan will take longer than expected, meaning it will keep incurring extra costs to ensure timely deliveries.

With an ongoing boom in passenger air travel and a strong U.S. dollar (the Americas account for 42 percent of revenues, according to Bloomberg data), these should be the best of times for Zodiac. Instead, American Airlines in September dropped it as a supplier of lie-flat business seats on some aircraft because of the delays. Airbus CEO Fabrice Bregier later accused Zodiac's management of having been "in denial," adding he had barred the company from a new aircraft program.

Since reaching a high last March, the stock has plunged almost 60 percent. Revenues grew only 2.6 percent last year when adjusted for currency and M&A effects. Net income fell by almost half.

Zodiac took on more orders than it could handle and has taken too long to get a grip on the self-described "seat crisis." That in turn reflects weaknesses in management, planning and processes that have put important customer relationships at risk. Various managers have been replaced but CEO Olivier Guy Zarrouati should accept some responsibility.

He needs to explain better why he couldn't foresee the latest profit threat in November, when Zodiac reported full-year results. Christophe Menard at Kepler Cheuvreux said "we've reached the stage where management can only be judged on its results, not its commitments."

So it seems odd that Zodiac's supervisory board renewed Zarrouati's contract for another four years in October, before the crisis was overcome. That may reflect in part the company's governance: various families and employees (including Zarrouati) hold more than 40 percent of voting rights, but only about a quarter of the shares.

While many of Zodiac's troubles are home-made, there are broader lessons for the industry on the vulnerability of its supply chain. Boeing and Airbus have bulging order books and plan to lift production. If suppliers can't keep pace, they'll have a problem.

However, consolidation among interior suppliers means airlines have fewer options when something goes wrong. In aircraft seating there are a handful of big suppliers left, including B/E Aerospace and Recaro. Diversifying that supplier base again — if that's what is needed — won't happen in a hurry.

A 2010 scandal involving Japanese supplier Koito, which falsified tests, means the certification process for seats is much more laborious. Perhaps instead of pressuring suppliers to develop ever more elaborate business class configurations, airlines could show restraint.

Criticizing Zodiac is warranted, but making sure supply chain problems don't resurface will be more difficult. If the industry doesn't succeed, Ryanair's standing-room only idea won't seem so outlandish.

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