ARMSTRONG WORLD INDUSTRIES INC
Form 10-Q
October 30, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2017

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission File Number 1-2116

ARMSTRONG WORLD INDUSTRIES, INC.

(Exact name of registrant as specified in its charter)

Pennsylvania (State or other jurisdiction of incorporation or organization)	23-0366390 (I.R.S. Employer Identification No.)
2500 Columbia Avenue, Lancaster, Pennsylvania (Address of principal executive offices)	17603 (Zip Code)

Registrant’s telephone number, including area code (717) 397-0611

Indicate by check mark whether the registrant; (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter time period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act:

Large accelerated filer	Accelerated filer	Non-accelerated filer
Smaller reporting company	Emerging growth company	

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

Number of shares of Armstrong World Industries, Inc.'s common stock outstanding as of October 24, 2017 – 52,795,753.

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When we refer to "AWI," the "Company," "we," "our" or "us," we are referring to Armstrong World Industries, Inc. and its subsidiaries.

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

Certain statements in this Quarterly Report on Form 10-Q and the documents incorporated by reference herein may constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Those forward-looking statements are subject to various risks and uncertainties and include all statements that are not historical statements of fact and those regarding our intent, belief or expectations, including, but not limited to, our expectations concerning our residential and commercial markets and their effect on our operating results; our expectations regarding the payment of dividends; and our ability to increase revenues, earnings and EBITDA (as such terms are defined by documents incorporated by reference herein). Words such as "anticipate," "expect," "intend," "plan," "target," "project," "predict," "believe," "may," "will," "would," "could," "should," "seek," "estimate" and similar expressions identify such forward-looking statements. These statements are based on management's current expectations and beliefs and are subject to a number of factors that could lead to actual results materially different from those described in the forward-looking statements. Although we believe that the assumptions underlying the forward-looking statements are reasonable, we can give no assurance that our expectations will be attained. Factors that could have a material adverse effect on our financial condition, liquidity, results of operations or future prospects or which could cause actual results to differ materially from our expectations include, but are not limited to:

- global and domestic economic conditions;
- construction activity;
- the tax consequences of the separation of the flooring business from our ceilings (building products) business;
- competition;
- key customers;
- availability and costs of raw materials and energy;
- international operations;
- Worthington Armstrong Venture ("WAVE"), our joint venture with Worthington Industries, Inc.;
- environmental matters;
- covenants in our debt agreements;
- our indebtedness;
- our liquidity;
- strategic transactions;
- negative tax consequences;
- defined benefit plan obligations;
- claims and litigation;
- labor;
- intellectual property rights;
- costs savings and productivity initiatives; and
- other risks detailed from time to time in our filings with the Securities and Exchange Commission (the "SEC"), press releases and other communications, including those set forth under "Risk Factors" included in our Annual Report on Form 10-K and in the documents incorporated by reference.

Such forward-looking statements speak only as of the date they are made. We expressly disclaim any obligation to release publicly any updates or revisions to any forward-looking statements to reflect any change in our expectations with regard thereto or change in events, conditions or circumstances on which any forward-looking statement is based.

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Armstrong World Industries, Inc., and Subsidiaries

Condensed Consolidated Statements of Earnings and Comprehensive Income

(amounts in millions, except per share data)

Unaudited

	Three Months Ended September 30, 2017	Three Months Ended September 30, 2016	Nine Months Ended September 30, 2017	Nine Months Ended September 30, 2016
Net sales	$ 351.9	$ 334.9	$ 998.1	$ 936.6
Cost of goods sold	241.0	225.2	676.8	651.1
Gross profit	110.9	109.7	321.3	285.5
Selling, general and administrative expenses	55.8	55.7	162.8	165.2
Separation costs	-	2.0	-	33.0
Equity earnings from joint venture	(13.9)	(19.0)	(51.9)	(57.0)
Operating income	69.0	71.0	210.4	144.3
Interest expense	9.1	9.0	27.5	43.4
Other non-operating expense	1.7	-	3.6	-
Other non-operating (income)	(3.0)	(1.6)	(7.4)	(8.9)
Earnings from continuing operations before income taxes	61.2	63.6	186.7	109.8
Income tax expense	17.7	7.7	70.9	44.4
Earnings from continuing operations	43.5	55.9	115.8	65.4
Net (loss) from discontinued operations, net of tax expense of $ -, $-, $- and $ 0.1	-	-	-	(4.5)
Gain from disposal of discontinued business, net of tax (benefit) of ($5.9), ($14.7), ($5.4) and ($16.6)	5.9	14.7	5.3	16.7
Net gain from discontinued operations	5.9	14.7	5.3	12.2
Net earnings	$ 49.4	$ 70.6	$ 121.1	$ 77.6
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments	7.0	(2.0)	20.9	(13.8)
Derivative (loss) gain	(0.3)	1.7	(2.0)	1.2
Pension and postretirement adjustments	14.3	6.9	18.8	23.9
Total other comprehensive income	21.0	6.6	37.7	11.3
Total comprehensive income	$ 70.4	$ 77.2	$ 158.8	$ 88.9
Earnings per share of common stock, continuing operations:				
Basic	$ 0.82	$ 1.00	$ 2.16	$ 1.17
Diluted	$ 0.81	$ 0.99	$ 2.14	$ 1.16

Earnings per share of common stock, discontinued operations:				
Basic	$ 0.11	$ 0.26	$ 0.10	$ 0.22
Diluted	$ 0.11	$ 0.26	$ 0.10	$ 0.22
Net earnings per share of common stock:				
Basic	$ 0.93	$ 1.27	$ 2.26	$ 1.39
Diluted	$ 0.92	$ 1.26	$ 2.24	$ 1.38
Average number of common shares outstanding:				
Basic	53.0	55.5	53.5	55.6
Diluted	53.5	56.0	53.9	56.0

See accompanying notes to Condensed Consolidated Financial Statements beginning on page 8.

Armstrong World Industries, Inc., and Subsidiaries

Condensed Consolidated Balance Sheets

(amounts in millions, except share and per share data)

	Unaudited September 30, 2017	December 31, 2016
Assets		
Current assets:		
Cash and cash equivalents	$ 116.5	$ 141.9
Accounts and notes receivable, net	142.5	108.3
Inventories, net	117.8	109.0
Income tax receivable	7.4	26.2
Other current assets	23.6	20.8
Total current assets	407.8	406.2
Property, plant, and equipment, less accumulated depreciation and amortization of $497.5 and $445.5, respectively	699.0	669.6
Prepaid pension costs	91.2	56.6
Investment in joint venture	105.4	106.2
Goodwill and intangible assets, net	450.3	434.5
Deferred income taxes	11.6	15.4
Income taxes receivable	-	5.7
Other non-current assets	64.4	63.8
Total assets	$ 1,829.7	$ 1,758.0
Liabilities and Shareholders' Equity		
Current liabilities:		
Current installments of long-term debt	$ 32.5	$ 25.0
Accounts payable and accrued expenses	169.8	197.1
Income tax payable	3.6	2.0
Total current liabilities	205.9	224.1
Long-term debt, less current installments	825.3	848.6
Postretirement benefit liabilities	80.2	84.8
Pension benefit liabilities	90.4	86.3
Other long-term liabilities	27.6	29.1
Income taxes payable	31.8	62.2
Deferred income taxes	202.3	156.5
Total non-current liabilities	1,257.6	1,267.5
Shareholders' equity:		
Common stock, $0.01 par value per share, 200 million shares authorized, 60,719,298 shares issued and 52,792,644 shares outstanding as of September 30, 2017 and	0.6	0.6

60,597,140 shares issued and 54,428,233 shares outstanding as of December 31, 2016		
Additional paid-in capital	512.6	504.9
Retained earnings	599.7	469.9
Treasury stock, at cost, 7,926,654 shares as of September 30, 2017 and 6,168,907		
shares as of December 31, 2016	(380.6)	(305.2)
Accumulated other comprehensive (loss)	(366.1)	(403.8)
Total shareholders' equity	366.2	266.4
Total liabilities and shareholders' equity	$ 1,829.7	$ 1,758.0

See accompanying notes to Condensed Consolidated Financial Statements beginning on page 8.

Armstrong World Industries, Inc., and Subsidiaries

Condensed Consolidated Statements of Shareholders’ Equity

(amounts in millions, except share data)

Unaudited

Nine Months Ended September 30, 2017

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings	Treasury Stock Shares	Treasury Stock Amount	Accumulated Other Comprehensive (Loss)	Total
Balance at beginning of period	54,428,233	$ 0.6	$ 504.9	$ 469.9	6,168,907	$ (305.2)	$ (403.8)	$ 266.4
Cumulative effect impact of ASU 2016-09 adoption				8.7				8.7
Stock issuance	122,158							
Share-based employee compensation			6.8					6.8
Net earnings				121.1				121.1
Separation of Armstrong Flooring, Inc.			0.9					0.9
Other comprehensive income							37.7	37.7
Acquisition of treasury stock	(1,757,747)				1,757,747	(75.4)		(75.4)
Balance at end of period	52,792,644	$ 0.6	$ 512.6	$ 599.7	7,926,654	$ (380.6)	$ (366.1)	$ 366.2

Nine Months Ended September 30, 2016

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings	Treasury Stock Shares	Treasury Stock Amount	Accumulated Other Comprehensive (Loss)	Total
Balance at beginning of period	55,359,064	$ 0.6	$ 1,151.8	$ 365.2	5,057,382	$ (261.4)	$ (487.4)	$ 768.8
Stock issuance	147,488							
Share-based employee compensation			13.1					13.1
Net earnings				77.6				77.6
Separation of Armstrong Flooring, Inc.			(660.7)				56.8	(603.9)
Other comprehensive income							11.3	11.3
	(187,331)				187,331	(7.8)		(7.8)

Acquisition of treasury stock								
Balance at end of period	55,319,221	$ 0.6	$ 504.2	$ 442.8	5,244,713	$ (269.2)	$ (419.3)	$ 259.1

See accompanying notes to Condensed Consolidated Financial Statements beginning on page 8.

Armstrong World Industries, Inc., and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(amounts in millions)

Unaudited

	Nine Months Ended September 30, 2017	2016
Cash flows from operating activities:		
Net earnings	$121.1	$77.6
Adjustments to reconcile net earnings to net cash provided by (used for) operating activities:		
Depreciation and amortization	62.9	70.1
Write off of debt financing costs	-	1.1
Deferred income taxes	53.0	28.0
Share-based compensation	8.1	9.6
Excess tax benefit from share-based awards	-	(5.8)
Equity earnings from joint venture	(51.9)	(57.0)
Separation costs	-	33.0
Loss on interest rate swap	-	10.7
U.S. pension expense	2.0	11.8
Other non-cash adjustments, net	(0.5)	(4.2)
Changes in operating assets and liabilities:		
Receivables	(27.4)	(41.3)
Inventories	(1.5)	(4.4)
Other current assets	(3.6)	11.5
Other non-current assets	(3.3)	(7.0)
Accounts payable and accrued expenses	(35.9)	(88.2)
Income taxes payable	(7.8)	(24.1)
Other long-term liabilities	(8.8)	(19.4)
Other, net	(1.5)	(4.6)
Net cash provided by (used for) operating activities	104.9	(2.6)
Cash flows from investing activities:		
Purchases of property, plant and equipment	(63.2)	(75.7)
Return of investment from joint venture	52.8	68.5
Cash paid for acquisition	(31.4)	-
Other investing activities	0.5	0.3
Net cash (used for) investing activities	(41.3)	(6.9)
Cash flows from financing activities:		
Proceeds from revolving credit facility and other short-term debt	103.0	90.0
Payments of revolving credit facility and other short-term debt	(103.0)	(90.0)
Proceeds from long-term debt	-	363.5
Payments of long-term debt	(16.8)	(432.8)

Financing costs	(0.6)	(8.1)
Proceeds from exercised stock options	0.6	0.3
Cash transferred to Armstrong Flooring, Inc.	-	(9.1)
Excess tax benefit from share-based awards	-	5.8
Payment for treasury stock acquired	(75.4)	(7.8)
Net cash (used for) financing activities	(92.2)	(88.2)
Effect of exchange rate changes on cash and cash equivalents	3.2	(4.6)
Net (decrease) in cash and cash equivalents	(25.4)	(102.3)
Cash and cash equivalents at beginning of year	141.9	244.8
Cash and cash equivalents at end of period	$116.5	$142.5
Supplemental Cash Flow Disclosures:		
Interest paid	$23.1	$25.2
Income tax payments, net	20.2	23.9
Amounts in accounts payable for capital expenditures	1.8	4.7

See accompanying notes to Condensed Consolidated Financial Statements beginning on page 8.

Armstrong World Industries, Inc., and Subsidiaries

Notes to Condensed Consolidated Financial Statements (unaudited)

(dollar amounts in millions, except share data)

NOTE 1. BUSINESS AND BASIS OF PRESENTATION

Armstrong World Industries, Inc. ("AWI") is a Pennsylvania corporation incorporated in 1891. When we refer to "AWI," the "Company," "we," "our" or "us" in these notes, we are referring to AWI and its subsidiaries.

The accounting policies used in preparing the Condensed Consolidated Financial Statements in this Form 10-Q are the same as those used in preparing the Consolidated Financial Statements for the year ended December 31, 2016. These statements should therefore be read in conjunction with the Consolidated Financial Statements and notes that are included in the Form 10-K for the fiscal year ended December 31, 2016. In the opinion of management, all adjustments of a normal recurring nature have been included to provide a fair statement of the results for the reporting periods presented. Operating results for the third quarter and first nine months of 2017 and 2016 included in this report are unaudited. Quarterly results are not necessarily indicative of annual earnings, primarily due to the different level of sales in each quarter of the year and the possibility of changes in general economic conditions.

On April 1, 2016, we completed our separation of Armstrong Flooring, Inc. ("AFI"). AFI's historical financial results have been reflected in AWI's Consolidated Financial Statements as a discontinued operation for all periods presented. Separation costs for the three and nine months ended September 30, 2016 were $2.0 million and $33.0 million, respectively. Separation costs were recorded within the Unallocated Corporate segment. Separation costs primarily related to outside professional services and employee compensation, retention and severance accruals.

On January 13, 2017, we acquired the business and assets of Tectum, Inc. ("Tectum"), based in Newark, Ohio. Tectum is a manufacturer of acoustical ceiling, wall and structural solutions for commercial building applications with two manufacturing facilities. Tectum's operations from the date of acquisition, and its assets and liabilities as of September 30, 2017, have been included as a component of our Americas segment. See Note 3 for additional information.

These Condensed Consolidated Financial Statements are prepared in accordance with U.S. generally accepted accounting principles ("U.S. GAAP"). The statements include management estimates and judgments, where appropriate. Management utilizes estimates to record many items including certain asset values, allowances for bad debts, inventory obsolescence and lower of cost and net realizable value charges, warranty reserves, workers' compensation, general liability and environmental claims, and income taxes. When preparing an estimate, management determines the amount based upon the consideration of relevant information. Management may confer with outside parties, including outside counsel. Actual results may differ from these estimates.

Certain prior year amounts have been recast in the Condensed Consolidated Financial Statements to conform to the 2017 presentation.

Recently Adopted Accounting Standards

In July 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2015-11, "Simplifying the Measurement of Inventory," which requires inventory that is measured on a first-in, first-out or average cost basis to be measured at lower of cost and net realizable value, as opposed to the lower of cost or market. For inventory that is measured under the last-in, first-out ("LIFO") basis or the retail recovery method, there is no change to current measurement requirements. The adoption of this standard on January 1, 2017 did not have an impact on our financial condition, results of operations or cash flows.

In March 2016, the FASB issued ASU 2016-09, "Improvements to Employee Share-Based Payment Accounting." This new guidance simplifies accounting for share-based payments, most notably by requiring all excess tax benefits and tax deficiencies to be recorded as income tax benefits or expense in the income statement and by allowing entities to recognize forfeitures of awards when they occur. Effective January 1, 2017, we adopted the provisions of ASU 2016-09 and elected to continue to estimate the impact of forfeitures when determining share-based compensation cost. We prospectively adopted the provisions of this new guidance related to the recognition of excess tax benefits and deficiencies through income tax expense, the presentation of excess tax benefits from share-based compensation as operating cash outflows, and changes to diluted earnings per share computations, the impact of which were not material to our Condensed Consolidated Statements of Earnings and Comprehensive Income or Condensed Consolidated Statements of Cash Flows. Finally, as required by ASU 2016-09, effective January 1, 2017, we recorded an $8.7 million cumulative-effect increase to Retained earnings and Deferred income taxes (assets), representing prior years' tax benefits that were not previously recognized because the related tax deductions had not reduced income taxes payable.

Recently Issued Accounting Standards

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers." The guidance requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to a customer. The

ASU will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. In March 2016, the FASB issued ASU 2016-08, "Principal versus Agent Considerations (Reporting Gross versus Net)," which clarifies the implementation guidance relating to principle versus agent considerations. In April 2016, the FASB issued ASU 2016-10, "Identifying Performance Obligations and Licensing," which clarifies the implementation guidance relating to the identification of performance obligations in a contract, including how entities should account for shipping and handling services it provides after control of goods transfers to a customer. In May 2016, the FASB issued ASU 2016-12, "Narrow-Scope Improvements and Practical Expedients," which clarifies the guidance related to the presentation of sales taxes, noncash consideration, and completed contracts and contract modifications. In December 2016, the FASB issued ASU 2016-20, "Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers," which clarifies the scope and application of the adoption of the new revenue recognition standard.

Collectively, the revenue recognition ASC updates are effective for annual reporting periods beginning after December 15, 2017, but early adoption is permitted. We intend to adopt these standards effective January 1, 2018 using the modified retrospective transition method and also intend to apply all practical expedients related to completed contracts upon adoption. Substantially all of our revenues from contracts with customers are recognized from the sale of products with standard shipping terms, sales discounts and warranties. As such, and based on our evaluation to date, we do not believe adoption will have a material impact to our financial condition, results of operations or cash flows as we expect the amount and timing of substantially all of our revenues will continue to be recognized at a point in time. Upon adoption, we will be impacted by the expanded disclosure requirements of the revenue recognition ASC updates, most notably the disclosure of revenues from contracts with customers into disaggregated categories. We are still assessing the impact of the new disclosure requirements of the revenue recognition ASC updates.

In January 2016, the FASB issued ASU 2016-01, "Recognition and Measurement of Financial Assets and Financial Liabilities," which addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. Most notably, this new guidance requires equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. This new guidance is effective for annual reporting periods beginning after December 15, 2017. We do not believe the adoption of this standard will have a material impact on our financial condition, results of operations and cash flows.

In February 2016, the FASB issued ASU 2016-02, "Leases," which amends accounting for leases, most notably by requiring a lessee to recognize the assets and liabilities that arise from a lease agreement. Specifically, this new guidance will require lessees to recognize a liability to make lease payments and a right-of-use asset representing its right to use the underlying asset for the lease term, with limited exceptions. The accounting applied by a lessor is largely unchanged from that applied under existing U.S. GAAP. This new guidance is effective for annual reporting periods beginning after December 15, 2018 and must be adopted under a modified retrospective basis. We are currently evaluating the impact the adoption of this standard will have on our financial condition, results of operations and cash flows.

In August 2016, the FASB issued ASU 2016-15, "Classification of Certain Cash Receipts and Cash Payments." This guidance clarifies how entities should classify certain cash receipts and cash payments on the statement of cash flows. This new guidance is effective for annual periods beginning after December 15, 2017. We are currently evaluating the impact the adoption of this standard will have on our cash flows.

In March 2017, the FASB issued ASU 2017-07, "Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost," which requires companies to report the service cost component of net benefit cost in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. This new guidance is effective for annual periods beginning after December 15, 2018 and will have an impact on the classification of net benefit costs, which are currently included as a component of Costs of goods sold and Selling, general and administrative ("SG&A") expenses, on our Condensed Consolidated Statements of Earnings and Comprehensive Income. See Note 13 for details related to our components of net benefit costs.

In August 2017, the FASB issued ASU 2017-12, "Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities," which amends the financial reporting of hedging relationships in order to better portray the economic results of an entity's risk management activities in its financial statements. In addition, this new guidance simplifies the application of current hedge accounting guidance. This new guidance is effective for annual periods beginning after December 15, 2018. We are currently evaluating the impact the adoption of this standard will have on our financial condition, results of operations and cash flows.

Armstrong World Industries, Inc., and Subsidiaries

Notes to Condensed Consolidated Financial Statements (unaudited)

(dollar amounts in millions, except share data)

NOTE 2. SEGMENT RESULTS

Our reportable operating segments consist of the following three distinct geographical segments: Americas (including Canada); Europe, Middle East and Africa (including Russia) ("EMEA"); and Pacific Rim. Balance sheet items classified as Unallocated Corporate primarily include cash and cash equivalents, the estimated fair value of interest rate swap contracts and outstanding borrowings under our senior credit facilities. The majority of expenses for our corporate support functions are allocated to our Americas segment.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Net sales to external customers				
Americas	$233.8	$226.0	$679.2	$640.9
EMEA	76.5	74.2	211.8	199.4
Pacific Rim	41.6	34.7	107.1	96.3
Total net sales to external customers	$351.9	$334.9	$998.1	$936.6

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Segment operating income (loss)				
Americas	$67.6	$68.6	$214.7	$189.0